Annex B

EXAMINATION OF BUDGET 2008 INCOME TAX MEASURES USING THE POVERTY IMPACT ASSESSMENT GUIDELINES.

Background

The Office for Social Inclusion located in the Department of Social and Family Affairs issued new guidelines during 2006, subsequently updated during 2007, which are to be used by Government departments for assessing policies and programmes at design, implementation and review stages in relation to the likely impact that they will have or have had on poverty and on inequalities which are likely to lead to poverty, with a view to poverty reduction. The guidelines, which replace the previous poverty proofing guidelines issued by the Department of Social and Family Affairs, are known as poverty impact assessment guidelines.

The primary aim of the poverty impact assessment process is to identify the impact of the policy proposal on those experiencing poverty or at risk of falling into poverty so that this can be given proper consideration in designing or reviewing the policy. It is not intended that all policies be fundamentally transformed so that they are explicitly targeted at the disadvantaged but rather that any possible negative impacts be identified and measures put in place to ameliorate such impacts. Likewise, it is important that positive impacts are identified so that they can be enhanced if possible.

Considerations to bear in mind

The Social Welfare measures in Budget 2008 will accrue mostly to those at the lower end of the income distribution who, without such measures, would experience a significant deterioration in their income in relative terms.

The ESRI SWITCH model was utilised to analyse the impact of the combined effect of social welfare changes and the tax changes contained in Budget 2008. This tax-benefit model is based on data drawn from the Central Statistics Office Survey on Income and Living Conditions (SILC) for 2005. The model calculates the percentage change in disposable income across each income decile as a result of Budget 2008. This is done by comparing the 2007 tax and welfare regimes using projected 2008 incomes against the 2008 tax and welfare regimes using 2008 projected incomes.

The model (see Figure 1 following) shows that the most significant percentage gains in disposable income are to those on the lowest incomes, while much smaller percentage gains accrue to those in middle to high-income brackets. This analysis reflects the progressive nature of Budget 2008, which sees those dependent on welfare getting the greatest gains. From a distributional point of view, Budget 2008 ensures that the lowest income groups gain progressively more (from welfare payments) than the higher income groups, who contribute progressively more to the cost of public service provision. The overall distributional effect is similar to that achieved in the last five Budgets.

Budget 2008 targets over 54% of the resources in the personal income tax package towards those on low incomes, as well as the elderly, lone parents, widowed persons and widowed parents and those with a disability or those who care for a person with a disability.

Those at the lower end of the income distribution will also benefit from taxation measures if they become exempt. In this regard, the entry point to taxation has been increased in Budget 2008 (as it has been in every Budget since 1997).

The statutory minimum wage came into effect in April 2000 (at £4.40/€5.59 per hour). Since then, the value of the minimum wage has been increased six times by almost 55% in all and now stands at €8.65 per hour. Budget 2006 increased the value of the basic personal tax credit and the employee tax credit to ensure that the minimum wage in its annualised form was placed outside the tax net. This remained the position throughout 2006 and 2007. Budget 2008, through increases in the basic personal tax credit and the employee tax credit, raises the level of the entry point to taxation for the single employee aged under 65 years by about 4% from €17,600 in 2007 to €18,300 in 2008, significantly above the annualised figure for the minimum wage (€17,542). In addition, the employee weekly threshold for liability to PRSI is increased from €339 to €352 thus ensuring that no PRSI liability will arise on such a wage. The Health Levy threshold is also being increased by €20 from €480 per week to €500 per week which will ensure that a person earning up to €26,000 per annum will not be liable for the levy.

The impact on poverty is one criterion for assessing the Budget. There are other acknowledged goals and targets such as increasing economic efficiency, rewarding effort and enterprise and encouraging capital accumulation, all of which improve economic welfare generally and are additional to the fundamental role of budgeting revenue and expenditure. Also, in terms of looking at the Budget's impact on poverty, it is necessary to consider not only the income tax measures which it contains but also: -

(a) the additional increment of social inclusion spending provided for through specific Budget measures. In Budget 2008, the value of these is about €1.44 billion for 2008 over and above those provided for in the Pre Budget Outlook;
and

(b) the aggregate value of social inclusion spending across all Government programmes which is provided for annually through the Estimates process and the Budget. It is estimated that in 2008, this spending, including social welfare payments, will amount to about €29.7 billion, an increase of €2.7 billion compared with 2007 and representing almost 48% of gross total expenditure on public services.

These expenditures may be particularly relevant to, and of benefit to, those in the lower income categories referred to below who do not pay tax and are, therefore, not affected by tax changes.

Early Childcare Supplement

The Early Childcare Supplement, introduced in Budget 2006, and the social welfare measures announced in Budget 2008, together with the income tax changes to the extent that they apply, will have a significant beneficial impact for those on low incomes. The Early Childcare Supplement is being increased in Budget 2008 and qualifying earners will receive an additional €100 in 2008 for each child under six years of age compared with supplement payments received in 2007. The payment will continue to be made separately from, and in addition to, Child Benefit. It is not means-tested and is exempt from income tax. As a flat rate payment, the supplement is of greater significance for those on lower incomes whether they are inside the tax net or already outside it.

Poverty Impact Assessment of Income Tax Measures

The 2008 Budget income tax package was screened in accordance with the requirements outlined in Stage 1 of the Poverty Impact Assessment guidelines prepared by the Office for Social Inclusion (OSI). Having regard to the significance of the income tax package in terms of overall national policy, the change it will bring about in an existing policy and its relevance to certain persons and groups, it was necessary to carry out a poverty impact assessment in accordance with Stage 2 of the guidelines. The individuals and groups in question include persons in each of the key lifecycle stages identified in the National Action Plan for Social Inclusion 2007-2016 (NaPinclusion) [1] and some or all of the groups[2] identified as being most vulnerable to poverty or social exclusion in the Poverty Impact Assessment Guidelines published by the OSI.

Consultation

A pre-Budget consultation process was undertaken, whereby organisations and individuals made written and oral submissions to the Tánaiste and to the Department of Finance regarding the nature, extent and focus of income tax changes in Budget 2008. Specifically in relation to personal income tax, the Tánaiste received of the order of 30 written pre-Budget submissions from a range of organisations and individuals who either represent many of the vulnerable groups outlined above or who put forward proposals which would be of benefit to such groups.

In addition, issues identified as being relevant to the Budget income tax package were discussed by the Tax Strategy Group as part of its schedule of meetings which take place every year during the annual Budget and Finance Bill cycle.

What is the primary objective of this policy/programme/expenditure proposal?

It is the established and generally accepted view that the fundamental role of taxation is to raise revenue to fund the provision of services by the State. In providing these services the State has its various policy objectives, including tackling disadvantage. In looking at the effect of changes to income tax it needs to be borne in mind that what is at issue is the change in tax paid by income earners - those in lower income categories do not pay income tax. For 2008, it is estimated that about 20% of those returning income for tax purposes will pay approximately 77% of all income tax. Accordingly, changes to income tax affect some sections of the population more than others and do not affect those on low incomes not paying tax.

Who is the proposal aimed at and how will the proposal affect those persons or groups?

An Agreed Programme for Government provides that "*Our first priority remains low and middle income earners – therefore our first task will be to use tax credits and bands to keep low income earners out of the standard rate band and average earners out of the higher band*". This provision, along with others relating to personal taxation, is to be implemented *"subject to the controlling economic and fiscal framework"*.

[1] The NAP inclusion reflects the lifecycle approach of the partnership agreement Towards 2016. The key lifecycle stages are identified as children, people of working age, older people and people with disabilities.

[2] Women, lone-parent families, families with large numbers of children, people with disabilities, unemployed, members of the travelling community, people experiencing rural disadvantage, people experiencing urban poverty, homeless, migrants and ethnic minorities.

The Government Programme sets out guiding principles for economic and fiscal policy which include commitments to

- *"..... operate a responsible fiscal policy characterised by broad budget balance and a declining debt burden*
  and
- *Keep the overall tax burden low and implement further changes to enhance the rewards of work while increasing the fairness of the tax system."*

The provisions of the current Partnership Agreement are consistent with these commitments.

The proposal is aimed at all income earners with priority being given to low and middle income earners, consistent with the Government Programme commitment. In addition, the protection of more vulnerable groups in society has been given priority. It is expected that Budget 2008 will target over 54% of the resources in the personal income tax package towards those on low incomes, as well as the elderly, lone parents, widowed persons and widowed parents and those with a disability or those who care for a person with a disability.

The target groups will be affected through measures designed to change the personal income tax system which are announced on Budget day and subsequently provided for in law through the Finance Bill. In all cases, the personal income tax measures in Budget 2008 are designed to be of benefit to the target groups and individuals.

What are the differences within the target group/between the target groups which might lead to them benefiting from the policy/programme in different ways and how could these be addressed?
The differences between the target groups may be identified by reference to levels of income and differences in personal circumstances, including age, disability, and the need to care for dependants. The circumstances of different target groups are addressed through adjustment of reliefs which focus on those groups. Clear examples of this are the Age Exemption limits which target relief at those aged 65 or over and are being increased by over 5% to €20,000 single/€40,000 married, the Incapacitated Child tax credit which is being increased by 22% to €3,660 and the Widowed Parent tax credit which is being increased significantly and which provides additional tax relief to widowed parents with dependent children in the years immediately following bereavement.

Consider what data is available within own organisation, other departments or agencies or from alternative sources. Identify data or indicators against which progress can be measured.
The key data on which decisions in relation to the budget income tax changes are made are provided using the tax forecasting computer model[3] operated by the Revenue Commissioners. This model can provide information on how tax changes impact on individual income earners or groups of earners or all income earners as well as estimates of the costs of such changes. In addition, the Income Tax Policy Section of the Department of Finance operates a computer system which enables changes to the personal income tax system to be modelled and which provides data on net income changes for different categories of income earner. The ESRI

[3] The model is based on an extract from the main computer record of the latest complete historical income distribution data for a specified tax year. That extract is used as the "*base year*" data for the model. It contains details of incomes, tax credits and allowances and tax liabilities (including nil liabilities) of PAYE and self employed income earners at individual level.

SWITCH model may also be utilised to analyse the income distribution effects of the combined impact of Budget tax and social welfare changes.

Besides the use of computer models, information derived from the Parliamentary process, from representations, from pre-Budget meetings and submissions may be taken into account in the formulation of the Budget income tax package.

What type of impact on poverty would the proposal have, in particular for the persons in each of the key lifecycle stages identified in the National Action Plan for Social Inclusion 2007-2016 (NaPinclusion) and to some or all of the groups identified as being most vulnerable to poverty or social exclusion in the Poverty Impact Assessment Guidelines published by the Office for Social Inclusion?

As indicated earlier, it needs to be borne in mind that what is at issue is the change in tax paid by income earners. The tax system as currently structured can only impact on earners in the groups mentioned to the extent that they receive income and pay tax. However, in relation to those identified for priority attention in the Government Programme and in the Budget 2008 income tax package, that is, low and middle income earners as well as vulnerable groups including those in need of care, the elderly and those with a disability, by increasing levels of net income as well as increasing the reward for work, as appropriate, the Budget's income tax changes help to prevent people in such groups from falling into poverty. Also, as already indicated, from a distributional point of view, the combined tax and social welfare measures in Budget 2008 ensure that those dependent on welfare get the greatest gains.

Budget 2008, through increases in the basic personal tax credit and the employee tax credit, raises the level of the entry point to taxation for the single employee aged under 65 years by almost 4% from €17,600 in 2007 to €18,300 in 2008. As such, over €351 per week of earnings is made free of tax. In addition, the exemption limits from income tax for persons aged 65 and over are being increased by an annual sum of €1,000 single/€2,000 married bringing them to €20,000 and €40,000. Over seven years, these limits have increased in value by over 85%. In comparison, it is estimated that in the seven years 2002 to 2008 the cost of living as measured by the Consumer Price Index will have increased by about 27%.

If the proposal would have no effect on poverty what options might be identified to produce a positive effect?

Changes to income tax affect some sections of the population more than others and do not affect those not paying tax. As already indicated, it is necessary to take the social welfare measures in Budget 2008 into account as well as taxation measures and direct social inclusion spending planned for 2008.

If the proposal would have a positive effect on poverty would it help to prevent people falling into poverty; reduce the level (in terms of numbers and depth) of poverty and/or ameliorate the effects of poverty ?

Changes to direct taxation will not directly impact on those in the lowest income households who are already by and large outside of the tax net. Budget 2008 will keep 39,100 earners out of the tax net. For 2008, the total number of income earners outside the tax net is expected to be 878,100 or 37.6% of income earners. For a married couple with one income (PAYE) and a carer in the home, over €614 per week is made free from tax while for a single PAYE person of working age over €351 per week of income becomes free from tax.

Altogether, the Budget 2008 income tax measures help to improve the welfare of people on lower incomes. Removing additional lower income earners from the tax net helps to increase disposable incomes at this level. Similarly, the increases in the basic personal and employee (PAYE) tax credits and in the health levy threshold will mean that the circumstances of certain workers on lower incomes, and who continue to be in the tax net, will be improved. Furthermore, in keeping with the commitment in *An Agreed Programme for Government,* increases in the standard rate band will ensure that all those of working age with incomes at or below €35,400, that is significantly above the average industrial wage as projected for 2008, will not have a liability to tax at the higher rate.

If the proposal would have a negative effect (e.g. by increasing the numbers in poverty or the level of poverty experienced) what options could be considered to ameliorate this effect?
The income tax changes do not have a negative effect on poverty.

Would the policy/programme/proposal contribute to the achievement of the NAPinclusion targets (including the subsidiary targets) ?
Insofar as persons experiencing consistent poverty or persons in each of the key lifecycle stages identified in the NAPinclusion are within the tax net, the Budget income tax measures will contribute to progress towards the overall NAPinclusion targets to reduce poverty for those persons.

Would the policy/programme/proposal address inequalities that might lead to poverty ?
By taking more of the lower paid out of the tax net and by reducing tax at lower levels of income, the income tax measures address inequalities that might lead to poverty. To the extent that target groups are income earners, the income tax measures will impact positively on their welfare. The tax changes will keep 39,100 earners from the tax net and will reduce the burden for other low income households. In addition, the increase in the health levy threshold will benefit 40,100 persons.

Improvements to the Family Income Supplement, the increase in Child Benefit, the new Early Childcare Supplement, and the increases in other social welfare payments, achieve balance in the distributional effects of this Budget. Responsibility for poverty impact assessment of social welfare expenditure measures lies with the Department of Social and Family Affairs.

The basis for this assessment is the analysis by both the Department of Finance and the Revenue Commissioners of the distributional impact of the changes to income tax in Budget 2008. Examples 1 - 12 in Annex A show the net income changes for a range of incomes and family types including the impact of Child Benefit, the Early Childcare Supplement and FIS. Figures 2 – 4 below show the net income gains for Single, Married One Earner (Two Children) and Married Two Earners (Two Children) on full rate PRSI as a result of the Budget personal income tax measures and the changes in the PRSI threshold and ceiling and the health levy threshold. In addition, the SWITCH model has been used to assess the distributional impact of the tax and social welfare measures in the Budget.

Will this proposal be adopted?
Yes. It is intended that the Budget 2008 income tax package will be adopted subject to the measures being approved in the Finance Bill process by the Oireachtas.

If the proposal is to be adopted, how will its impact on poverty be monitored?
The impact of Budget income tax measures on the lower paid insofar as it removes earners from the tax net and reduces the tax burden for other low income households is monitored on a continuing basis as part of the annual Budget and Finance Bill cycle.

Figures

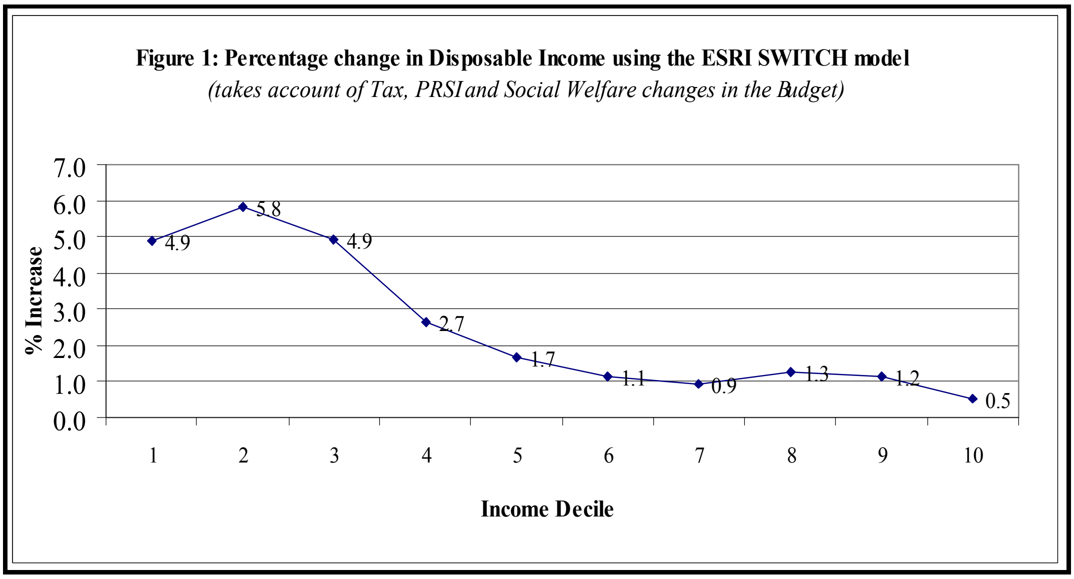

Figure 1: Percentage change in Disposable Income using the ESRI SWITCH model
(takes account of Tax, PRSI and Social Welfare changes in the Budget)
% Increase
7.0
6.0
5.0
4.0
3.0
2.0
1.0
0.0
4.9
5.8
4.9
2.7
1.7
1.1
0.9
1.3
1.2
0.5
1
2
3
4
5
6
7
8
9
10
Income Decile

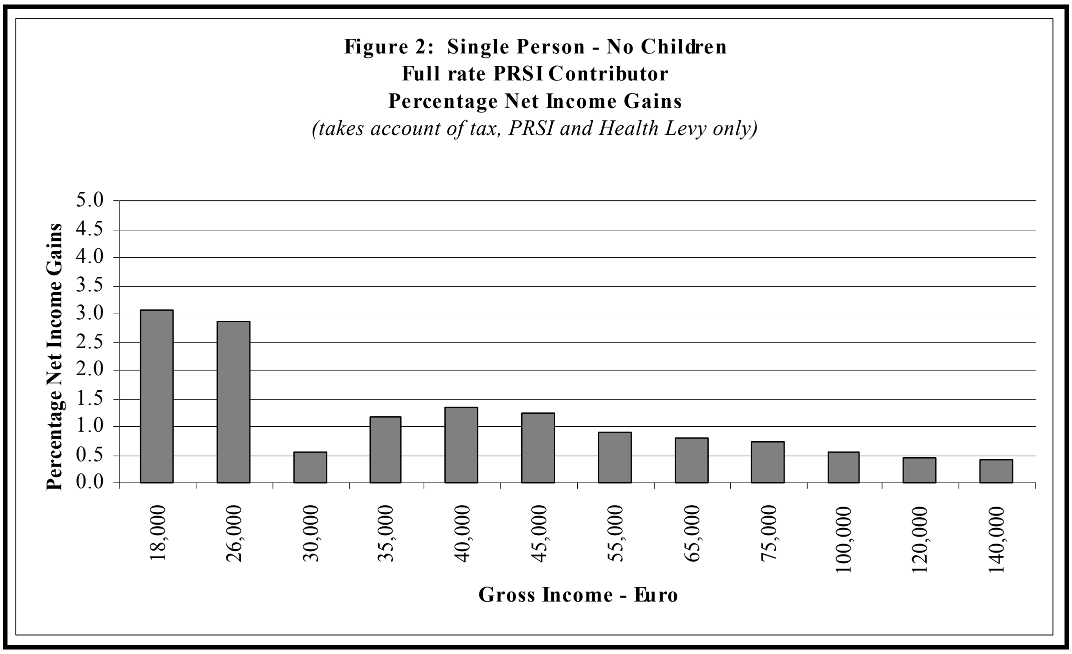

Figure 2: Single Person - No Children
Full rate PRSI Contributor
Percentage Net Income Gains
(takes account of tax, PRSI and Health Levy only)
Percentage Net Income Gains
5.0
4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
18,000
26,000
30,000
35,000
40,000
45,000
55,000
65,000
75,000
100,000
120,000
140,000
Gross Income - Euro

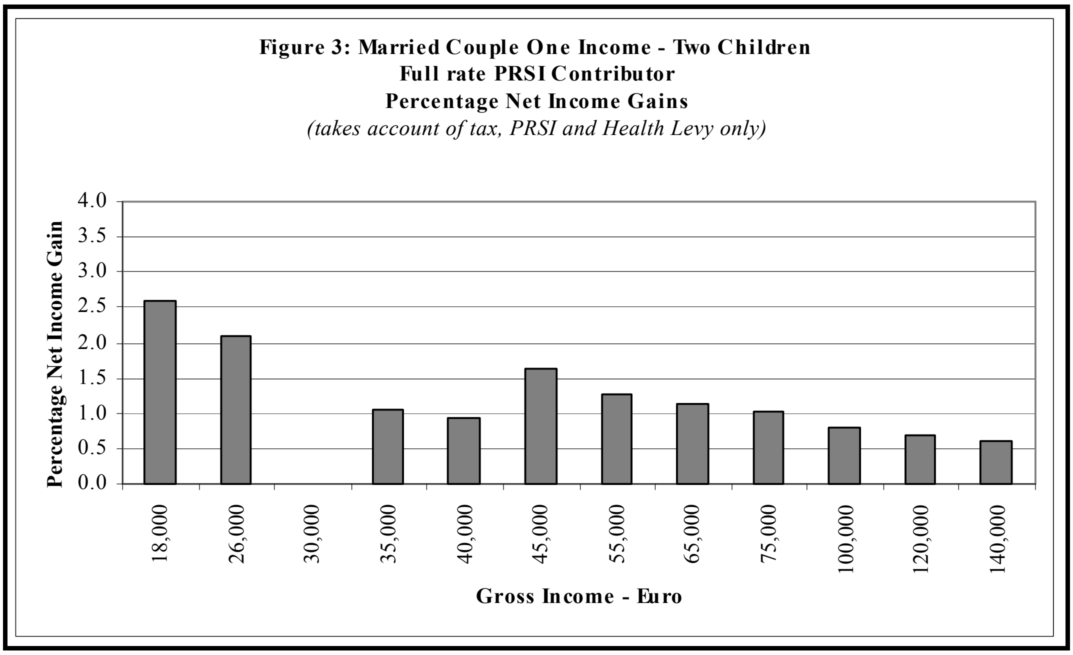
Figure 3: Married Couple One Income - Two Children
Full rate PRSI Contributor
Percentage Net Income Gains
(takes account of tax, PRSI and Health Levy only)
Percentage Net Income Gain
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
18,000
26,000
30,000
35,000
40,000
45,000
55,000
65,000
75,000
100,000
120,000
140,000
Gross Income - Euro

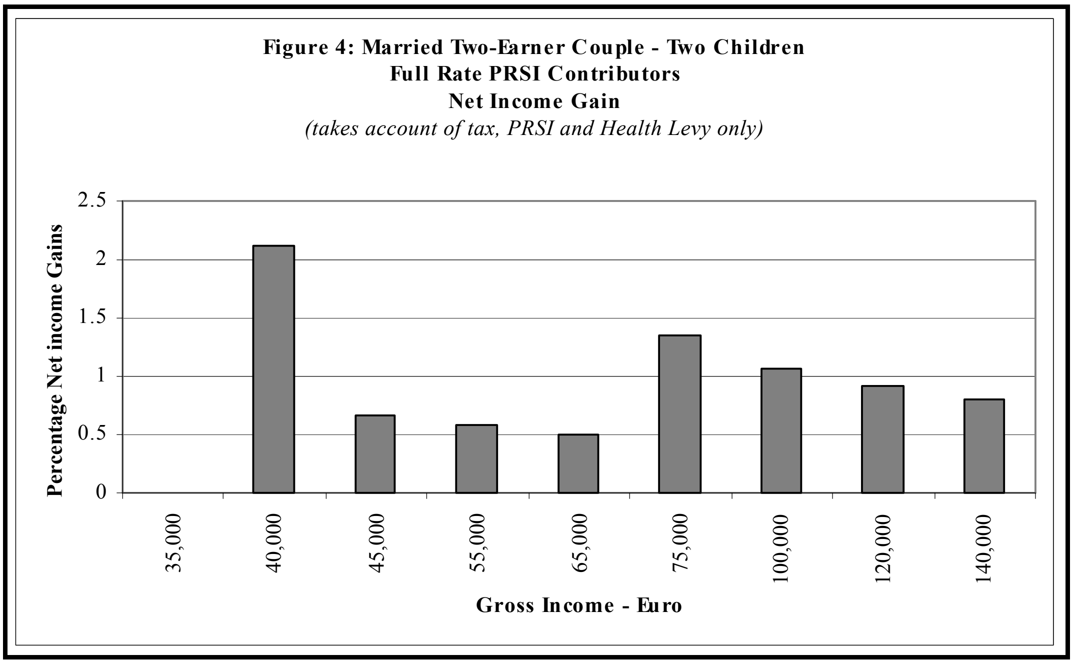
Figure 4: Married Two-Earner Couple - Two Children
Full Rate PRSI Contributors
Net Income Gain
(takes account of tax, PRSI and Health Levy only)
Percentage Net income Gains
2.5
2
1.5
1
0.5
0
35,000
40,000
45,000
55,000
65,000
75,000
100,000
120,000
140,000
Gross Income - Euro