Annex B

EXAMINATION OF BUDGET 2009 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, which have subsequently been updated in 2007 and 2008, 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 2009 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 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. The entry point to taxation for the single employee aged under 65 years stands at €18,300 in 2009, significantly above the annualised figure for the minimum wage (€17,542). In addition, the employee weekly threshold for liability to PRSI at €352 ensures that no PRSI liability will arise on such a wage. After Budget 2009 the minimum wage will remain outside a liability to pay income tax and PRSI. The Health Levy threshold will remain at €500 per week which will ensure that a person earning up to €26,000 per annum will not be liable for the Health levy.

The income levy introduced in Budget 2009, which applies at the rate of 1% on income of up to €100,100 per annum and 2% on income in excess of that amount, arises from the need to raise significant amounts of revenue in 2009. At lower income levels, the impact is cushioned by increases in family income supplement and by an exemption from the levy for social welfare payments including contributory and non-contributory State pensions. In addition, the increase in the tax bands also helps alleviate the effect of the levy for those with average and moderate incomes. Furthermore, the increase in mortgage interest relief for first-time buyers will help alleviate the burden of mortgages on this group.

The impact on poverty is only one criterion for assessing the Budget. Budget 2009 was framed against the background of a rapid turnaround in our economic fortunes. Ireland is confronting major economic challenges - from both domestic and external sources - with the economy experiencing a contraction in activity this year and the next. This continues to have a major impact on the public finances, with tax revenue declining by over 10 per cent this year and only moderately increasing next year, taking account of the Budget measures.

One of the main purposes of the Budget is to restore confidence in the public finances by putting them back on a more sustainable track over the medium term. Acting decisively in this regard will help restore confidence and certainty in the Irish public finances and in the wider economy. 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 the increase spending on social inclusion as well as 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 2009, this spending, including social welfare payments, will amount to about €32.3 billion, an increase of €2.6 billion compared with Budget 2008, despite the economic circumstances, and representing almost 50.5% of gross total expenditure on public services.

These expenditures may be particularly relevant to, and of benefit to, those in the lower income categories who do not pay tax.

Poverty Impact Assessment of Income Tax Measures

The 2009 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 measures and new income levy 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 Minister and to the Department of Finance regarding the nature, extent and focus of income tax and other changes in Budget 2009. Specifically in relation to personal income tax, the Minister received of the over 40 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.

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. Given the challenging economic environment at present, the primary objective of this Budget was to raise additional revenue to fund these services in a fair and progressive manner. In providing these services the State has met its various policy objectives, including tackling disadvantage.

[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.

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".*

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 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. In the current challenging economic situation the provisions of Budget 2009 protects the advances made in the last number of years in respect of the low and middle income earners

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. A clear example of this is the way in which the income levy has been structured: those with higher incomes pay at the higher 2% rate while various alleviation measures, through improvements in FIS, the exemption of social welfare payments including social welfare State pensions, and the increases in bands, assist those on low and middle incomes. It should also be noted that the base to which the income levy applies is gross income i.e. before capital allowances, exemptions or contributions to superannuation schemes. These are generally available only to those on higher incomes.

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 SWITCH model may

[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.

also be utilised to analyse the income distribution effects of the combined impact of Budget tax and social welfare changes. It was not possible in the time available this year to enhance the SWITCH model in order to assess the new income levy (and changes to bands) in conjunction with 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 (either in terms of numbers in poverty or level of poverty) would the proposal have, in particular for the vulnerable groups identified?
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. The income tax package outlined in Budget 2009 is progressive in that it taxes the higher paid most, thereby providing revenue to increase social welfare spending that targets vulnerable groups. Examples of this are increases in Family Income Supplement, contributory and non-contributory pensions, invalidity pensions, illness/jobseeker benefit, jobseekers allowance and disability allowance.

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 income tax. As already indicated, it is necessary to take the social welfare measures in Budget 2009 into account as well as taxation measures and direct social inclusion spending planned for 2009.

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 income tax net. The exemption provided in the new income levy for social welfare payments and the State contributory and non-contributory pensions, changes to FIS and other social welfare payments protects the most vulnerable and should assist in helping prevent people falling into poverty.

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?
As the income tax changes and new income levy are progressive, they should have a minimal negative effect on poverty.

Would the policy/programme/proposal contribute to the achievement of the NAPinclusion targets (including the subsidiary targets) ?
Yes, as outlined before, the proposal is progressive in that it taxes the higher paid most, thereby providing the resources for increases in social welfare payments.

Would the policy/programme/proposal address inequalities that might lead to poverty ?
By maintaining generous tax and health levy exemptions for the lower paid and increasing taxes for the higher paid the proposal can be said to be addressing inequalities that might lead to poverty.

Improvements to the Family Income 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 taxes on income in Budget 2009. Examples 1 – 8 in Annex A show the net income changes for a range of incomes and family types. Figures 2 to 4 below show the net income changes for married and single persons over a range of income while Figure 1 shows the distributional impact of social welfare changes in the Budget.

Will this proposal be adopted?
Yes. It is intended that the Budget 2009 measures 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 tax measures on the lower paid, insofar as it maintains a low tax burden for low income households, is monitored on a continuing basis as part of the annual Budget and Finance Bill cycle.

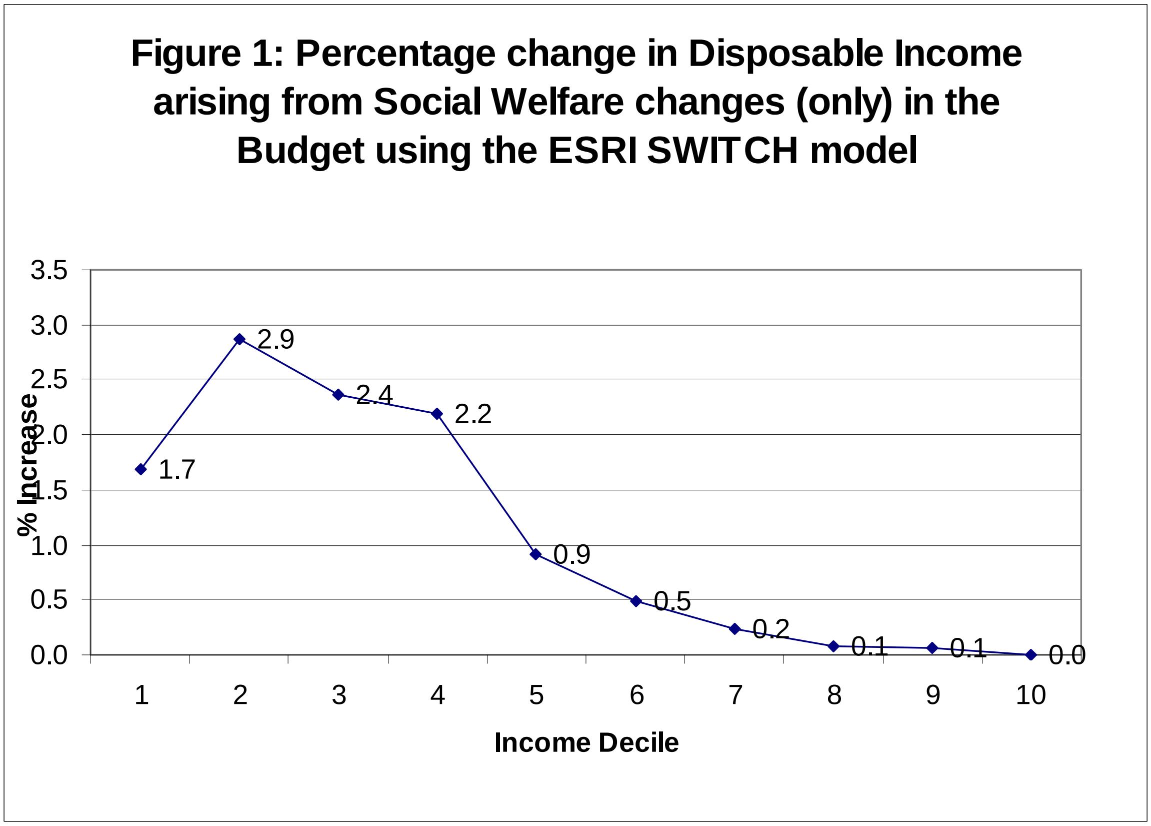
Figure 1: Percentage change in Disposable Income arising from Social Welfare changes (only) in the Budget using the ESRI SWITCH model
% Increase
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
1.7
2.9
2.4
2.2
0.9
0.5
0.2
0.1
0.1
0.0
1
2
3
4
5
6
7
8
9
10
Income Decile

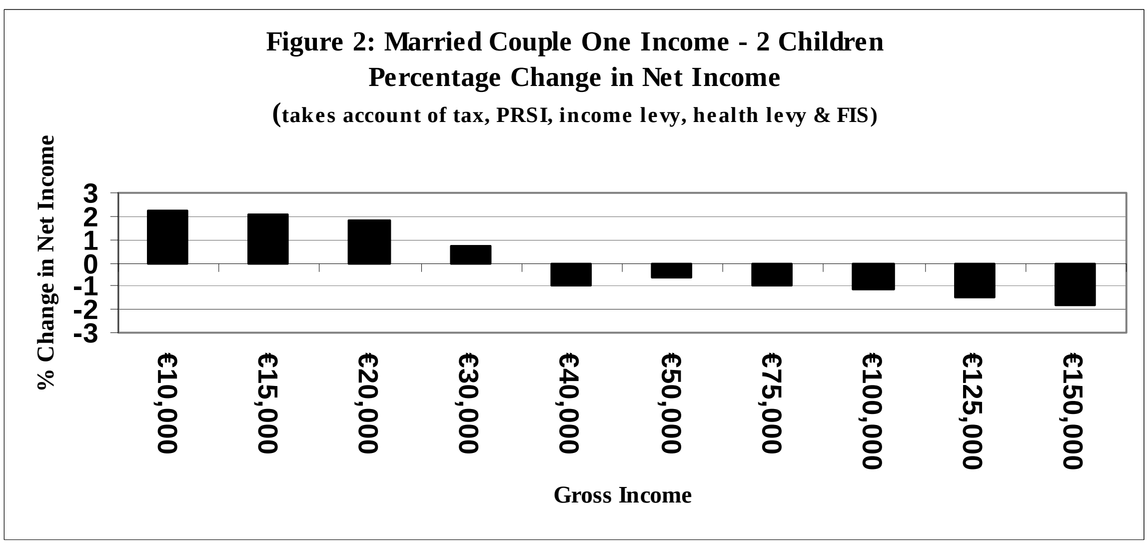
Figure 2: Married Couple One Income - 2 Children
Percentage Change in Net Income
(takes account of tax, PRSI, income levy, health levy & FIS)
% Change in Net Income
3
2
1
0
-1
-2
-3
€10,000
€15,000
€20,000
€30,000
€40,000
€50,000
€75,000
€100,000
€125,000
€150,000
Gross Income

Figure 3: Married Couple Two Income - 2 Children
Percentage Change in Net Income
(takes account of tax, PRSI, income levy, health levy & FIS)

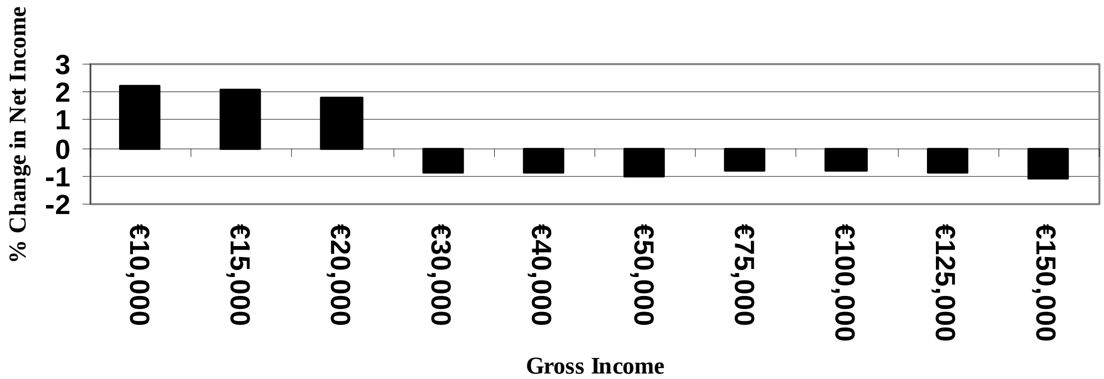

Figure 4: Single Person - No Children
Percentage Change in Net Income
(takes account of tax, PRSI, income levy & health levy)