Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Box F: QB 4 – October 2020

This Box content is extracted from the Quarterly Bulletin – Q4 2020

The resilience of income tax in 2020

By Rónán Hickey, David Horan and Enda Keenan[1]

Developments in Irish corporation tax have rightly received significant attention in recent years. This is reflective of their rapid growth, the disproportionate role they have played in driving total tax growth and the narrow nature of the tax base. In nominal terms, however, income tax remains Ireland's largest tax head, and its importance has grown following the introduction of the Universal Social Charge (USC) – and its predecessor the income levy - in 2009. As Chart A shows, income tax represented an average of 30 per cent of total tax revenue throughout the 2000s. Following the financial crisis, however, this figure has grown to around 40 per cent, with the USC responsible for much of the increase.

Chart A: Tax Heads as Proportion of total tax

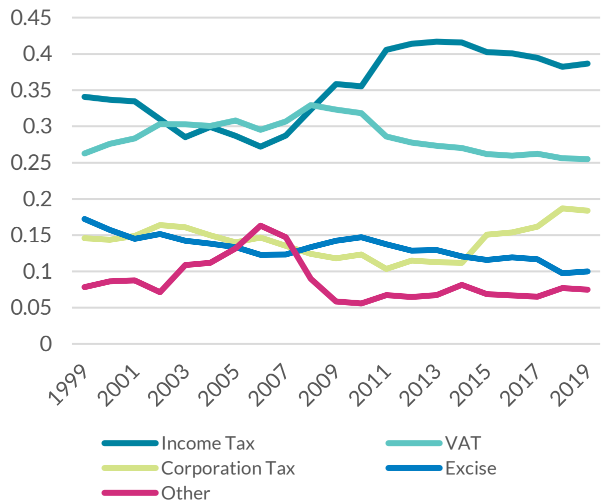
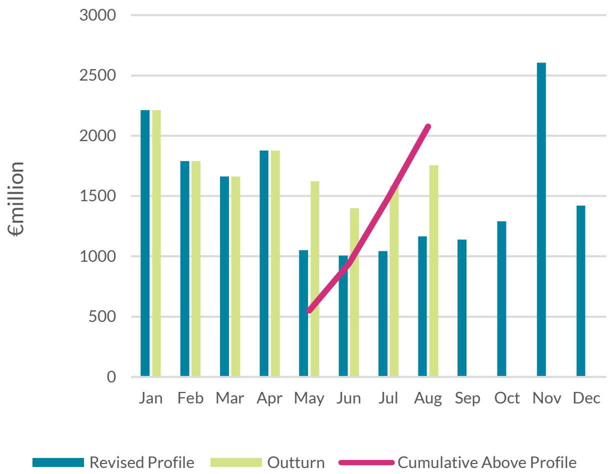


Chart B: Income Tax Profile and Outturn, 2020



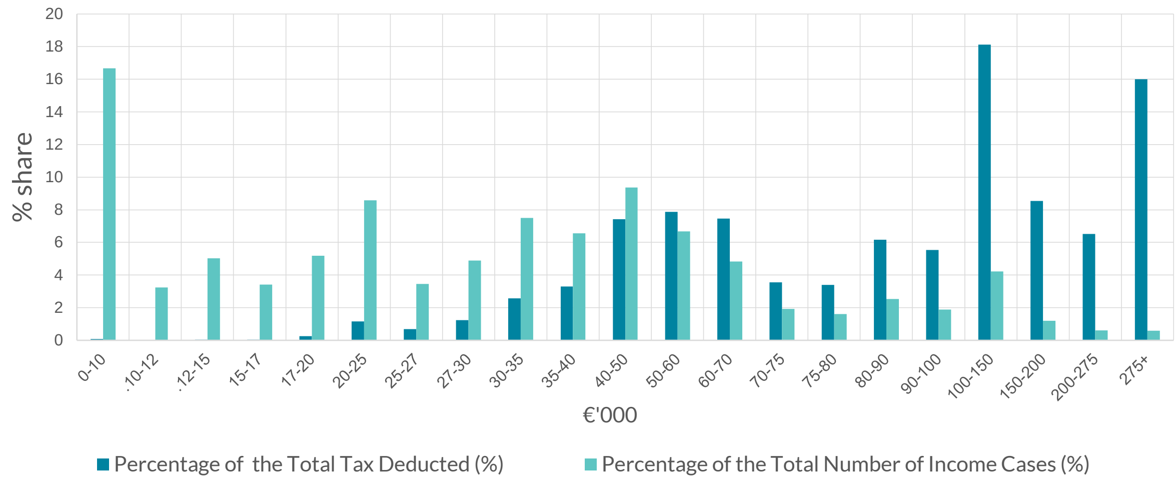
Turning to developments this year, income tax receipts have proven to be extremely resilient despite the strong adverse impact of the pandemic on the labour market. In April, the Department of Finance revised down its Budget 2020 projection for income tax receipts by almost one-quarter (or by €5.6bn) against the backdrop of a severely weaker outlook for the labour market. Similarly, the fiscal deterioration outlined in Quarterly Bulletin volumes 2 and 3 for 2020 partly reflected an expectation

[1] Irish Economic Analysis

of a sharp decline in direct tax revenue. Following a very strong start to the year, which saw year-on-year growth of 13.5 per cent in the first quarter, income tax receipts have recorded annual declines in each month since the health crisis began. These declines, however, have not been of the magnitude expected; in August, for example, monthly receipts were €589m higher than anticipated. As Chart B shows this has resulted in cumulative income tax receipts of €2.1bn (17.6 per cent) higher than the revised profile for the first eight months of the year.

The better than expected performance appears to reflect the progressive Irish income tax system, coupled with the nature of the shock to the Irish labour market. The former is clearly illustrated in Chart C, which shows the percentage of income tax paid by income range for 2018 (the latest data available). This highlights the small proportion of the tax paid by lower income workers. Employment disruptions or job losses during the pandemic, meanwhile, have been disproportionately focused among these very workers at the lower-end of the income distribution. Research by Byrne et al (2020) on Pandemic Unemployment Payment claimants showed that affected workers are on average younger, employed on a part-time basis, more likely to be a citizen of another country, and more likely to be in their role for less than 12 months than the population average.[2] The latest Q2 2020 Labour Force Survey show employment decreases across all of these categories and most notably for part-time employment, down 12.5 per cent on annual basis compared to a fall of 1.1 per cent in full-time employment.

Chart C: Income Earners by Gross Income Range



Source: Central Statistics Office

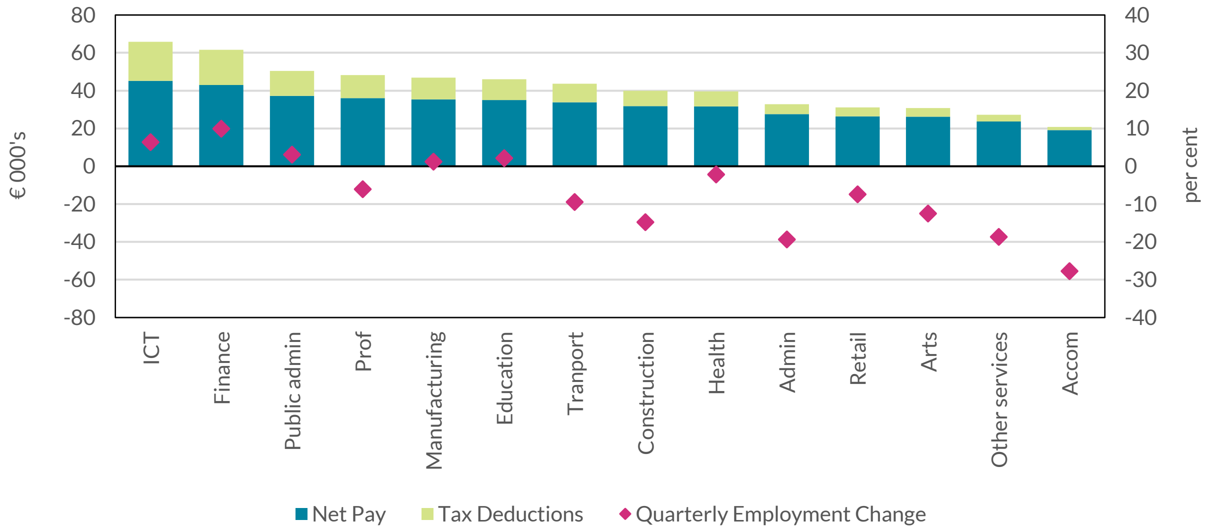
[2] Byrne et al (2020) "The Initial Labour Market Impact of COVID-19" Central Bank of Ireland Economic Letter Series. Vol 2020, No. 4

Analysis of Temporary Wage Subsidy Scheme (TWSS) data shows that, at peak levels, take-up was proportionately greater among employees in higher-wage sectors than compared to the PUP, suggesting employment disruption or job loss was more prevalent amongst workers in lower earning sectors. TWSS data releases from the Revenue Commissioners highlighted that employees in receipt of higher weekly earnings were also more likely to be in receipt of additional wage top-ups by their employer. While the government income-support subsidy is not subject to taxation at source, additional top-ups provided by the employer are subject to income tax and USC charges as they are recorded under gross pay. Analysis by Keenan and Lydon (2020) estimates that the average subsidy amounts in the TWSS decreased continually on a weekly basis due to composition effects of higher earning sectors flowing off of the scheme and lower wage sectors flowing on.[3]

Finally, CSO Earnings and Labour Costs (EHECS) data for Q2 2020 show that average weekly seasonally-adjusted earnings are highest for workers in the ICT sector (€1,258), which has a far greater working home applicability, compared to the lower earnings sectors such as accommodation and food services (€380) in which there is a higher proximity risk.[4] The tax liabilities of the workers in these sectors vary substantially from 31.3 per cent of gross earnings in ICT and 7.3 per cent in accommodation.[5] EHECS data also show that despite containment measures negatively influencing aggregate employment activities, a higher-wage sector such as ICT increased employment figures by 6.3 per cent quarter-on-quarter, while accommodation and food services decline by 27.8 per cent as firms closed premises in light of public health advice (Chart D). The increasing level of higher-income workers appears to have offset a proportion of the reduction in tax take from the much larger level of employment loss in severely affected consumer-facing sectors.

[3] Keenan and Lydon (2020) "Wage Subsidies and Job Retention" Central Bank of Ireland Economic Letter Series, (forthcoming)
[4] See Lydon, R. (2020) "CSO assessment of Occupations with Potential Exposure to COVID-19" The Irish Economy
[5] Calculations for income tax deductions are based on seasonally-adjusted weekly earnings scaled to annual levels for a single person with no dependents or pension contributions.

Chart D: Tax contributions and employment change



Source: CSO EHECS

While developments in the labour market and the progressive nature of the Irish income tax system explain the resilience of income tax in recent months, it should be noted that the outlook remains clouded by significant uncertainty. A further caveat is the high proportion of tax that is paid in the final two months of the year of the Irish tax system. Nevertheless, the strength of income tax – and direct taxes more broadly – provide a clear positive in an otherwise challenging fiscal environment.