NESC REPORT NO. 2

COMMENTS ON CAPITAL TAXATION PROPOSALS

Price: 90p

NATIONAL ECONOMIC AND SOCIAL COUNCIL

CONSTITUTION AND TERMS OF REFERENCE

1. The main task of the National Economic and Social Council shall be to provide a forum for discussion of the principles relating to the efficient development of the national economy and the achievement of social justice, and to advise the Government, through the Minister for Finance on their application. The Council shall have regard, *inter alia,* to:

(i) the realisation of the highest possible levels of employment at adequate reward,

(ii) the attainment of the highest sustainable rate of economic growth,

(iii) the fair and equitable distribution of the income and wealth of the nation,

(iv) reasonable price stability and long-term equilibrium in the balance of payments,

(v) the balanced development of all regions in the country, and

(vi) the social implications of economic growth, including the need to protect the environment.

2. The Council may consider such matters either on its own initiative or at the request of the Government.

3. Members of the Government shall be entitled to attend the Council's meetings. The Council may at any time present its views to the Government, on matters within its terms of reference. Any reports which the Council may produce shall be submitted to the Government and, together with any comments which the Government may then make thereon, shall be laid before each House of the Oireachtas and published.

4. The membership of the Council shall comprise a Chairman appointed by the Government in consultation with the interests represented on the Council

Ten persons nominated by agricultural organisations,
Ten persons nominated by the Confederation of Irish Industry and the Irish Employers' Confederation,
Ten persons nominated by the Irish Congress of Trade Unions,
Ten other persons appointed by the Government, and
Six persons representing Government Departments comprising one representative each from the Departments of Finance, Agriculture and Fisheries, Industry and Commerce, Labour and Local Government and one person representing the Departments of Health and Social Welfare.

Any other Government Department shall have the right of audience at Council meetings if warranted by the Council's agenda, subject to the right of the Chairman to regulate the numbers attending.

5. The term of office of members shall be for three years renewable. Casual vacancies shall be filled by the Government or by the nominating body as appropriate. Members filling casual vacancies may hold office until the expiry of the other members' current term of office and their membership shall then be renewable on the same basis as that of other members.

6. The Council shall have its own Secretariat, subject to the approval of the Minister for Finance in regard to numbers, remuneration and conditions of service.

7. The Council shall regulate its own procedure.

NATIONAL ECONOMIC AND SOCIAL COUNCIL

Comments on Capital Taxation Proposals

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Report No. 2

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PREFACE

In his Financial Statement on 3 April 1974, the Minister for Finance stated:

> "Consultations will be held with the National Economic and Social Council . . . regarding the considerations to be borne in mind in the taxation of farm profits. These consultations will also cover capital taxation and include consideration of the steps to be taken to encourage investment and greater production."

The Council's comments on the taxation of farm income were sent to the Minister for Finance on 17 May 1974. They are set out in Part II of this report. Part I contains the comments of the Council on the proposals for Capital Taxation.*

* A draft of this report was prepared by the Economic Policy Committee and discussed and amended by the Council at its meeting on 20 June 1974. The report was drafted by Mr. Tom Ferris of the Council's Secretariat.

PART I. COMMENTS ON CAPITAL TAXATION PROPOSALS

I. INTRODUCTION

1. The proposals in the White Paper on Capital Taxation published on 28 February 1974 can be summarised briefly as follows:

(i) *Capital Gains Tax:* Tax on realised gains at flat rate of 35% with certain exemptions and exceptions.

(ii) *Capital Acquisitions Tax:* Tax levied at progressive rates both on inheritances received on death and on gifts received during the life of the donor. Different scales of rates would apply for five different classes of beneficiaries, depending on the relationship to the person from whom the gift or inheritance was received.

(iii) *Annual Wealth Tax:* Annual tax on all property over £40,000 for a single person and over £60,000 for a married couple. The rates of tax would vary according to the amount of taxable net wealth, increasing from 1½% up to 2½%.

While the White Paper proposed no overall limit on the proportion of total income which might be taken by income tax and annual wealth tax, the Minister indicated his intention to adjust the higher rates of income taxation to mitigate possible hardship. With the introduction of a capital gains tax, an annual wealth tax and a capital acquisitions tax, the Government proposed to abolish estate duty, legacy duty and succession duty.

2. In his address to the Confederation of Irish Industry on 15 May 1974, the Minister for Finance announced his decision to modify the capital taxation proposals in the White Paper as follows:

(i) *Capital Gains Tax:*

(a) to reduce the rate from 35% to 26%;

(b) to exempt all realised gains on a principal private residence standing on grounds of up to 1 acre.

(ii) *Annual Wealth Tax:*

(a) to apply a single rate of 1% instead of rates of 1½% to 2½%;

(b) to increase exemption thresholds from £60,000 to £100,000 for a married man and from £40,000 to £70,000 for a single person, with an additional allowance for each minor child of £2,500 and a new exemption threshold of £90,000 for widowed persons;

(c) to revise these thresholds every three years to take account of inflation—valuations initially agreed would remain valid for three years;

(d) to introduce three new exemptions:

(1) principal private residence (including normal contents) standing on grounds of up to 1 acre;

(2) livestock and bloodstock;

(3) pension rights;

(e) to change the test for liability in respect of "world property" from domicile *or* ordinary residence (as proposed in the White Paper), to domicile *and* ordinary residence.*

(f) to reduce the higher rates of income tax with the introduction of wealth tax from 80% to 70%. The new top rate would apply to taxable incomes over £10,350 instead of £8,350 at present, by the substitution of three bands of £2,000 (chargeable at rates of 45%, 55% and 65% respectively) for the present two bands of taxable income chargeable at 50% and 65% respectively.

* Under the White Paper proposals the annual wealth tax would have applied to all "world property" of persons domiciled *or* ordinarily resident in the State. Such a proposal would have had the effect of taxing the "world wealth" of persons ordinarily resident but not domiciled in the State. For example, an American staying for three months of every year in Ireland would have been taxed on his total wealth, irrespective of its location. The revised proposals stipulate that "world wealth" would only be taxed on the basis of a test of domicile *and* ordinary residence. The tax would still apply to property in the State of persons not domiciled or resident here.

3. The council's comments, as set out below, relate to the White Paper's proposals as modified by the Minister for Finance in his speech to the C.I.I. on 15 May 1974. No comments are made on detailed technical issues. The comments set out below in Section II (Capital Gains Tax), Section III (Capital Acquisitions Tax), Section IV (Annual Wealth Tax) and Section V (The Proposals as a whole) command the general support of the Council, except in so far as is specifically indicated in the Addendum.

II. CAPITAL GAINS TAX

4. The proposals for a capital gains tax in the White Paper provide for a flat tax of 35% (subsequently reduced to 26%) on realised gains for all forms of property, when a gain is made on the disposal of such property. A capital gains tax in so far as it is levied on the appreciation of a capital asset falls between an income tax and a wealth tax. The tax as proposed in the White Paper would apply to the gain attributable from the date of purchase (or commencement date for the tax) to the date of disposal of the asset. All resident persons—i.e. individuals, companies and unincorporated bodies—would be liable to tax on the disposal of chargeable assets, wherever these assets were situated. Non-residents would be liable only in respect of capital gains on the disposal of real estate and business assets in the State. Such bodies as approved superannuation funds, qualified friendly societies and charities, which are now wholly exempt from income tax, would not be liable. The White Paper does not explain how trusts would be treated for capital gains taxation.

5. On valuation, the White Paper proposed that deductions could be made from the consideration received for the disposal of an asset. The deductions are as follows:

(a) costs of acquiring an asset including incidental costs;

(b) expenditure wholly and exclusively incurred to improve the value of the asset or to maintain the owner's right over it; and

(c) expenditure incidental to the disposal of the asset.

6. As regards exemptions and reliefs, the following were deemed relevant:

(a) Gains up to £15,000 from disposal of a principal private residence; normal life assurance policies; government securities; important works of art and similar objects; winnings from betting, lotteries and sweepstakes up to £15,000 in a single year.

(b) Capital gains by an individual up to £500 a year and disposals by an individual in any year of tangible movable property worth less than £2,000.

(c) Losses would only be allowed against chargeable gains.

(d) For sales within the family of farms and family businesses on retirement, the first £150,000 would not be taxed for capital gains,

(e) Tax on the sale of certain trade assets could be deferred if the proceeds of the sale were used to acquire new assets of a similar kind for exclusive use in the trade.

7. The Council agrees in principle to the introduction of a capital gains tax, but believes that the manner in which the taxable gain is calculated should take account of changes in the value of money. An important issue in capital gains taxation is whether the tax is levied on *nominal* or on *real* capital gains. If the value of an asset rises in line with the increase in prices in general, its real value is merely maintained. If in this case the tax is applied to the increase in the money value of the asset, it will eat into the real capital of the taxpayer. In other words, the capital gains tax will have been converted into a wealth tax—i.e. tax would be paid by a reduction in the real wealth of the taxpayer and not from the realisation of a gain in the real wealth which the taxpayer held. This would be a matter for concern if an annual wealth tax was at the same time in operation. It could, of course, be argued that this problem is not confined to capital gains tax. If personal allowances and marginal income tax rates are not adjusted in line with rising prices, then in an inflationary period real incomes after tax will be diminished. While we do not see this as desirable, if it occurs it does not eat into the assets from which the income arises. With earned income, the asset is human

capital—namely the skill, ability and drive of the income earner. This may not be diminished if income tax is not adjusted in line with inflation. However, the incentive to work could be reduced. In the case of non-human capital, a capital gains tax which took no account of inflation would eat into the capital and reduce both it, and its income-earning capacity, in real terms.

8. As proposed in the White Paper, capital gains tax would apply only to *realised* capital gains. If *unrealised* capital gains are not taxed a "lock-in" effect could result, i.e. a tendency to avoid selling assets and thus escape liability for capital gains tax.* A partial solution might be to treat gifts and death as deemed realisations. It might also be possible to assess unrealised gains at regular intervals and apply the capital gains tax to the increment in the value of the assets as shown by this assessment. However, taxation of unrealised gains could pose very difficult administrative (as well as economic and social) problems—for example, the tax paid on an unrealised gain might be greater than the tax liability on the gain realised on the subsequent sale of the asset. The Council accepts in principle the proposed tax on realised capital gains. The majority of the Council does not favour its extension to unrealised capital gains.

9. Unless it is the intention of a capital gains tax to tax purely nominal as distinct from real capital gains, we believe that account should be taken of changes in the value of money in computing the gain to which the tax would be applied. For example, capital gains (losses) might be deflated (inflated) by changes in the consumer price index (or other suitable index) since the date of purchase or during five years preceding sale (whichever is the shorter), to determine the sum of money to which capital gains tax might be applied.

10. Capital gains tax can impose heavy compliance costs on taxpayers. In general, the smaller the exemptions, the heavier will be the costs of complying with the requirements of the tax. We accept the exemptions proposed in paragraph 90 *(a)* of the White Paper as amended by the Minister in his speech of 15 May 1974.†

* As far as we can ascertain, no country taxes *unrealised* capital gains.

† The Minister announced that it is intended to exempt all gains realised on a principal private residence standing on grounds of up to 1 acre.

We also accept as reasonable the exemptions proposed in paragraph 90 *(b)* of the White Paper—they constitute a balance between minimising compliance costs and ensuring a yield from capital gains tax. If the broad range of exemptions were at a higher level, the proposals would not constitute equal treatment of persons of the same taxable capacity—i.e. "horizontal equity" would not be achieved. However, if the possibility of simplifying threshold requirements was being considered, it would be administratively simpler to have a threshold based on the *total* of disposals in any tax year, rather than a threshold related to the capital gain enjoyed in any tax year.

III. CAPITAL ACQUISITIONS TAX

11. We accept in principle the desirability of introducing a capital acquisitions tax on inheritances and gifts as an alternative to death duties. *Inheritance taxes* are levied on the value of legacies received by heirs, without regard to the size of estate from which the legacy comes; *gift taxes* are levied on the value of gifts received by donees. The capital acquisitions tax proposed in the White Paper referred to both inheritances and gifts. The tax would be levied at progressive rates on a successive slice system, with different scales of rates for different classes of beneficiaries, depending on their relationship to the person from whom the gift or inheritance was derived. As proposed, the tax would be levied in respect of property in excess of a certain amount acquired by any one donee/legatee from any one donor/testator. The liability for capital acquisitions tax would arise in the case of a gift at the date of the gift and in the case of an inheritance at the date of the relevant death. The ultimate liability to pay would fall on the beneficiary; concurrent liability would attach to donors, executors and trustees. For valuation, the open market value of property acquired would apply at the date of the transfer of ownership. Shares in private companies, annuities, life interests or reversions would be valued under special provisions. Agricultural land would be valued at 50% of market value up to £200,000, with market value being used in excess of that figure. *Bona fide* debts or encumbrances payable out of or charged on acquisitions would be allowed as deductions for tax purposes.

12. The proposals included different exemptions for the different classes of beneficiary. In Class I, a spouse or child would be taxed only on the property received in excess of £150,000. In Class II, lineal issue (other than those in Class I) and lineal ancestors would be taxed on property received in excess of £10,000. The threshold exemption for Class III (brothers and sisters) and Class IV (nephews and nieces) would be £5,000. All others were grouped under Class V, in which the threshold exemption would be £2,000. Acquisitions not exceeding £250 by any person from one donor in any one year were exempt, as were compensation or damages for personal injury, retirement gratuities or redundancy payments, objects of national, scientific, historic or artistic interest and acquisitions by charitable and public bodies. Two scales of tax applied to each of the five classes—one referred to all acquisitions received by a beneficiary during the lifetime of the donor, the other to the inheritances acquired on the donor's death. The proposed rate applicable to gifts was 25% below the level for inheritances, with the provision that the lower rate would not apply where gifts were made within two years of the death of a donor. Under the existing system of death duties, gifts are exempt from any tax unless made within five years of the death of the donor.

13. Death duties are levied under the present system on the estate of the deceased. They have obvious administrative advantages—e.g., the duties are levied at a time when the property is being valued in any case in order to effect the will of the deceased. Accordingly, only a proportion of total personal property is valued in any one year. Moreover, death duties tax property at the point where it is being transferred from legator to legatee. In the White Paper, it is argued that since much property passing on death comes as a windfall to the recipients, the death duties in many cases do not cause hardship. Moreover, in some cases reliefs and exemptions are given in relation to the circumstances of the beneficiaries. The disadvantages of death duties are that the provision for gifts *inter vivos* encourages people to make gifts at an early stage thereby avoiding payments of death duties. In addition, it is claimed that the burden of estate duty, the main form of death duty, has been responsible for the forced sales of family businesses and farms.

14. A capital acquisitions tax would have an advantage over estate

duty in that the tax is charged on what the beneficiary receives rather than on the total value of the estate. A capital acquisitions tax should, therefore, encourage wealth-holders to spread their wealth more widely, since the wider the distribution of wealth, the smaller the amount of total tax paid. With such a tax, there is a direct relationship between tax paid and benefit received. The capital acquisitions tax proposed in the White Paper would tax inheritances received on death as well as gifts received during life.

15. As proposed in the White Paper, the threshold of exemption for Class I under the capital acquisitions tax is very high. When account is taken of the high exemption of £150,000 for spouse and each child, the average rate of tax is very low, particularly when compared with estate duty which is related to the whole estate and not to the individual shares of the estate received by each beneficiary.

16. There appears to be some inconsistency in the rate structure for the different classes of inheritors. For example, the average rate of tax for Class II is lower than for Class I in the case of inheritances above £583,000. As regards Class III, the average rate of tax is lower than for Class I in the case of inheritances above £2,300,000. This peculiarity could introduce the phenomenon of "generation skipping", whereby less tax would be paid on a certain inheritance if passed to a grandchild from a testator, rather than to the spouse or child. This generation skipping might reduce the frequency with which tax was paid on particular properties.

17. In our view, too many consanguinity scales are suggested in the White Paper. As far as we can ascertain, there has been some tendency in other European countries to work towards a smaller number of categories. We accept the desirability of distinguishing different inheritors by reference to the relationship with the donor/testator, but believe that three consanguinity categories would be sufficient in Irish circumstances—namely,

Class A: spouse and children (including adopted children).
Class B: lineal issue, lineal ancestors, brothers, sisters, nephews, nieces, uncles and aunts.
Class C: all others.

The thresholds of exemption for Class A should be £100,000, for Class B, £10,000, and for Class C, £2,000. Should these consanguinity categories be accepted, it will be necessary to have the scale of rates for Class B adjusted to eliminate any incentive for "generation skipping", discussed in paragraph 16 above.

18. Even with fewer categories, one major problem would remain in the case where there is no spouse or children under Class A qualifying for an inheritance. For example, a significant number of Irish farmers are unmarried and a farm might be inherited by a nephew or brothers. If the thresholds for the categories proposed in the White Paper, namely Class II, Class III or Class IV, were applied, the farm might (despite the reduction in tax payable under the new tax proposals) have to be sold in whole or in part in order to pay capital acquisitions tax. This could be economically unsound and socially undesirable. The same situation could arise in the case of other businesses and professions. In our view, it would be desirable, in the case of trade, business or professional assets which are passed to one individual in our Class B, as the sole donee/legatee, that that person should be treated as if he were in our Class A, if he or she had been involved in the working of the farm, profession or business for a reasonable number of years preceding the date of acquisition.*

19. Even if the threshold for exemption for gifts or legacies to the immediate family were reduced to £100,000, the ownership of large amounts of wealth could be transferred without payment of tax if the size of the family were large. For example, an estate of £½ million equally divided among a spouse and four children would escape any capital acquisitions tax. We recognise the difficulties that would arise if the capital acquisitions tax proposals were modified so as to relate the exemption threshold (or the rates payable) to the amount of wealth possessed by the donor/legator at the time the gift was made or at the date of death. Indeed, any such modification would mean the maintenance of some form of estate duty, and there might be insuperable difficulties if the scheme were modified to cover both gifts and legacies.

* There was a division of opinion about whether this concession should apply only to cases in which there was no surviving relative in our Class A, or to cases in which there was no donee/legatee in Class A.

However, we believe that consideration should be given to relating the exemption threshold for Class A beneficiaries to the size of the estate being distributed at death. For example, the exemption threshold for legacies might be £100,000, or £300,000 divided by the number of Class A beneficiaries, which ever is the lower. This would provide a further incentive to gifts *inter vivos*, but we would not necessarily regard this as undesirable (see paragraph 20 below).

20. As far as we can ascertain, it is uncommon for gifts to be taxed at a rate which is different from the tax rate applied to inheritances. Of necessity, this must complicate the administration of a capital acquisitions tax. Indeed, the White Paper recognises that safeguards against death-bed gifts would have to be introduced whereby gifts made within two years of death would not qualify for the lower rate of tax. On the other hand, gifts taxed at a lower rate encourage the transfer of wealth at an earlier stage. Despite the administrative difficulties and problems treating gifts differently from inheritances, we accept the proposals in the White Paper whereby the rate applicable to gifts would be 25% below the rate for inheritances. We do so because we think that some encouragement of earlier transfers of assets could have advantages in-so-far as the recipients could acquire assets at an earlier age when they might be more likely to use them productively.

21. Under the proposed capital acquisitions tax, the rate of tax on any one gift or inheritance would be determined by reference to the cumulative total received from any *one* donor/testator. Where gifts or legacies are split up as between relatives passing on wealth and receiving wealth, there are possibilities for avoiding payment of capital acquisitions tax. Only under an *accessions* tax, where gifts and inheritances would be aggregated from *all* sources (and not merely from one donor/testator), could such tax avoidance be prevented. We believe that it would be desirable on all grounds to aggregate gifts and inheritances from *all* donors/testators in order to produce an all-embracing capital acquisitions tax. In effect, this would transform the acquisitions tax into an accessions tax. We recognise that this might not be administratively possible at this juncture, but we believe that steps should be taken to introduce an accessions tax as soon as feasible.

IV. ANNUAL WEALTH TAX

22. Individual taxes cannot be judged in isolation from the whole tax system. The proposed annual wealth tax must, therefore, be assessed in the context of the capital gains tax, the acquisitions tax and the proposals for corporation tax. Before we could comment on the wealth tax in this wider context certain matters must be clarified. The Minister in his address to the C.I.I. on 15 May 1974 indicated that particular consideration was being given to the form of relief which might be appropriate for productive capital used in business, and to the possibility of fixing an overall limit to the percentage of income that would be taken by income tax and wealth tax. In determining the treatment of productive assets it is important that such assets in Irish ownership should not be treated less favourably than if they had been in foreign company ownership.

23. An annual wealth tax is a tax on the value of net assets of all kinds. The White Paper proposed that the annual wealth tax would apply to net wealth on the basis of the market value of all property, real and personal, of every kind and wherever situated. Individual persons would be the taxpayers, although certain other entities would be treated as taxable units, e.g. private non-trading companies and discretionary trusts. Family wealth would also form a taxable unit, with regard to husband, wife and minor children. The beneficial owner of the property would be liable for tax. Since the tax would be a charge on the property, it would remain a charge in the hands of a purchaser. As proposed in the White Paper, the tax would apply to the "world property" of persons domiciled *or* ordinarily resident in the State. Favourable treatment of agricultural land was proposed, whereby the first £200,000 would be valued at 50% of market value, and any excess over £200,000 would be assessed at full market value.

24. The rates of tax proposed in the White Paper varied according to the amount of net wealth. The rates were on a successive slice basis as follows:

1½% on estates valued between £30,000 and £100,000
[single person]

1½% on estates valued between £50,000 and £100,000
[married persons]

2% on estates valued between £100,000 and £150,000
[all persons]

2½% on estates valued over £150,000
[all persons]

No overall limit was proposed for the proportion of total income which might be taken by income tax and annual wealth tax, although adjustments in higher rates of income tax were promised to mitigate possible hardship. In addition to owners of property below £40,000 (single person) and £60,000 (married couple) being exempt,* important works of art and other objects of national, scientific, historic or artistic interest would be exempt if they remained in the country and the public had reasonable access to them.

25. In his address to the Confederation of Irish Industry on 15 May 1974, the Minister for Finance announced certain modifications to the proposals in the White Paper. A single rate of 1% would be applied under the annual wealth tax instead of the rates of 1½% to 2½%. The exemption thresholds would be increased from £40,000 to £70,000 for a single person and from £60,000 to £100,000 for a married man. An allowance of £2,500 for each minor child would also be introduced, while a new exemption threshold of £90,000 would be provided for widowed persons. These thresholds would be revised every three years to take account of inflation and the valuations initially agreed would remain valid for three years. Three new exemptions would be introduced for:

(i) principal private residence (including normal contents) standing on grounds up to one acre,

(ii) livestock and bloodstock, and

(iii) pension rights.

The test of liability for taxation of "world property" would be domicile *and* ordinary residence.†

* While all wealth of single persons over £30,000 and wealth of married persons over £50,000 would be subject to the tax, a gap of £10,000 was proposed in the White Paper to minimise administrative costs both in the private and the public sectors.

† See footnote on page 5 above.

26. Adjustments in the higher rates of income tax, with the intention of mitigating possible hardship, were also announced by the Minister for Finance on 15 May 1974. With the introduction of an annual wealth tax, the top rate of income tax would be reduced from 80% to 70%. The new top rate of 70% would apply to taxable incomes over £10,350 instead of £8,350 as at present. This would be achieved through the substitution of three bands of £2,000 (each chargeable at rates of 45%, 55% and 65% respectively) instead of the present two bands taxable at 50% and 65% respectively. The modified rates of income tax would be as follows:

TABLE 1

Modified Rates of Tax

Rate of Tax	Taxable Income*	Cumulative Taxable Income
26%	First £1,550	£1,550
35%	next £2,800	£4,350
45%	next £2,000	£6,350
55%	next £2,000	£8,350
65%	next £2,000	£10,350
70%	Balance	—

* Taxable income is obtained by deducting from gross income whether earned income or investment income, the various allowances and reliefs to which a taxpayer is entitled. Income tax is then charged at the rates shown above on the successive slices of taxable income.

27. Examples of the combined effect of the modified income tax and proposed annual wealth tax are given in Tables 2 and 3 for a single man and a married couple. Rates of return on net wealth of 2%, 5% and 10% are examined in relation to different levels of net wealth, with an earned income of £5,500. The examples illustrate the degree to which it would be possible, except in the case of the very wealthy, to pay both income tax and annual wealth tax from income. However, under the assumption of a 2% return on wealth, the marginal rate of combined income tax and wealth tax exceeds 100% where net wealth is over £100,000 for a single person and over £200,000 for a married couple. Under the assumptions of 5% and 10% return on wealth, the marginal rate of combined income tax and annual wealth tax does not exceed 100%.

TABLE 2

Income tax and wealth tax for different levels of net wealth (single man)

Incorporating tax modifications announced by Minister for Finance on 15 May 1974

	Net Wealth	Income from Wealth/ Total Taxable Income	Income Tax	Rate of Income Tax		Wealth Tax	Combined IT + WT	Income After IT + WT	IT + WT as Percentage of	
				(a) marginal	*(b)* average				*(a)* marginal income*	*(b)* total income
	£	£	£	%	%	£	£	£	%	%
Assuming Return of 2% on Wealth	50,000	1,000 (6,000)	2,125·5	45	35·4	0	2,125·5	3,874·5	45	35·4
	100,000	2,000 (7,000)	2,640·5	55	37·7	300	2,940·5	4,059·5	105	42·0
	200,000	4,000 (9,000)	3,805·5	65	42·3	1,300	5,105·5	3,894·5	115	56·7
	500,000	10,000 (15,000)	7,938·0	70	52·9	4,300	12,238·0	2,762·0	120	81·6
	1,000,000	20,000 (25,000)	14,938·0	70	59·8	9,300	24,238·0	762·0	120	97·0
	2,000,000	40,000 (45,000)	28,938·0	70	64·3	19,300	48,238·0	−3,238·0	120	107·2
Assuming Return of 5% on Wealth	50,000	2,500 (7,500)	2,915·5	55	38·9	0	2,915·5	4,584·5	55	38·9
	100,000	5,000 (10,000)	4,455·5	65	44·6	300	4,755·5	5,244·5	85	47·6
	200,000	10,000 (15,000)	7,938·0	70	52·9	1,300	9,238·0	5,762·0	90	61·6
	500,000	25,000 (30,000)	18,438·0	70	61·5	4,300	27,738·0	7,262·0	90	75·8
	1,000,000	50,000 (55,000)	35,938·0	70	65·3	9,300	45,238·0	9,762·0	90	82·3
	2,000,000	100,000 (105,000)	70,938·0	70	67·6	19,300	90,738·0	14,762·0	90	85·9
Assuming Return of 10% on Wealth	50,000	5,000 (10,000)	4,455·5	65	44·6	0	4,455·5	5,544·5	65	44·6
	100,000	10,000 (15,000)	7,938·0	70	52·9	300	8,238·0	6,762·0	80	54·9
	200,000	20,000 (25,000)	14,938·0	70	59·8	1,300	16,238·0	8,762·0	80	65·0
	500,000	50,000 (55,000)	35,938·0	70	65·3	4,300	40,238·0	14,762·0	80	73·2
	1,000,000	100,000 (105,000)	70,938·0	70	67·6	9,300	80,238·0	24,762·0	80	76·4
	2,000,000	200,000 (205,000)	140,938·0	70	68·8	19,300	160,238·0	44,762·0	80	78·2

*The final increment of £100 of income from the appropriate amount of wealth (e.g., £1,000 assuming 10% return to wealth).

Assumption: Earned income of £5,500 and the minimum tax allowance of £500 for single man; hence taxable earned income is £5,000. The figures in brackets in column 2 are total taxable income. Effective wealth tax exemption threshold for single man taken at £70,000.

TABLE 3

Income tax and wealth tax for different levels of net wealth (married couple)

Incorporating tax modifications announced by Minister for Finance on 15 May 1974

	Net Wealth	Income from Wealth/ Total Taxable Income	Income Tax	Rate of Income Tax (a) marginal	Rate of Income Tax (b) average	Wealth Tax	Combined IT + WT	Income After IT + WT	IT + WT as Percentage of (a) marginal income*	IT + WT as Percentage of (b) total income
	£	£	£	%	%	£	£	£	%	%
Assuming Return of 2% on Wealth	50,000	1,000 (5,700)	1,990·5	45	34·9	0	1,990·5	3,709·5	45	34·9
	100,000	2,000 (6,700)	2,475·5	55	36·9	0	2,475·5	4,224·5	55	36·9
	200,000	4,000 (8,700)	3,610·5	65	41·5	1,000	4,610·5	4,089·5	115	53·0
	500,000	10,000 (14,700)	7,728·0	70	52·6	4,000	11,728·0	2,972·0	120	79·8
	1,000,000	20,000 (24,700)	14,728·0	70	59·6	9,000	23,728·0	972·0	120	96·1
	2,000,000	40,000 (44,700)	28,728·0	70	64·3	19,000	47,728·0	−3,028·0	120	106·8
Assuming Return of 5% on Wealth	50,000	2,500 (7,200)	2,750·5	55	38·2	0	2,750·5	4,449·5	55	38·2
	100,000	5,000 (9,700)	4,260·5	65	43·9	0	4,260·5	5,439·5	65	43·9
	200,000	10,000 (14,700)	7,728·0	70	52·6	1,000	8,728·0	5,972·0	90	59·4
	500,000	25,000 (29,700)	18,228·0	70	61·4	4,000	22,228·0	7,472·0	90	74·8
	1,000,000	50,000 (54,700)	35,728·0	70	65·3	9,000	44,728·0	9,972·0	90	81·8
	2,000,000	100,000 (104,700)	70,728·0	70	67·6	19,000	89,728·0	14,972·0	90	85·7
Assuming Return of 10% on Wealth	50,000	5,000 (9,700)	4,260·5	65	43·9	0	4,260·5	5,439·5	65	43·9
	100,000	10,000 (14,700)	7,728·0	70	52·6	0	7,728·0	6,972·0	70	52·6
	200,000	20,000 (24,700)	14,728·0	70	59·6	1,000	15,728·0	8,972·0	80	63·7
	500,000	60,000 (54,700)	35,728·0	70	65·3	4,000	39,728·0	14,972·0	80	72·6
	1,000,000	100,000 (104,700)	70,728·0	70	67·6	9,000	79,728·0	24,972·0	80	76·1
	2,000,000	200,000 (204,700)	140,728·0	70	68·7	19,000	159,728·0	44,972·0	80	78·0

*The final increment of £100 of income from the appropriate amount of wealth (e.g., £1,000 assuming 10% return to wealth).

Assumption: Earned income of £5,500 and the minimum tax allowance of £800 for married couple; hence taxable earned income is £4,700. The figures in brackets in column 2 are total taxable income. Effective wealth tax exemption threshold for married couples taken at £100,000.

28. Since assets such as the principal private residence and normal contents are exempt from annual wealth tax, the balance of net wealth is likely to consist of income-earning assets. As current yields on income-earning assets are above 2%,* it is unlikely that the marginal rate of tax would exceed 100% in reality. However, the tables illustrate how marginal tax would exceed 100% for certain levels of net wealth, if the average rate of return fell to 2% or less. In such circumstances, it would not be possible for a wealth-owner to pay the extra income tax and annual wealth tax from income and it would be necessary for him to dispose of part of his capital to pay the combined taxes. Accordingly, there could be an incentive to seek a return of above 2% on net wealth to ensure that income would be sufficient to pay both income tax and wealth tax. On the other hand, the effect might be to create a disincentive of saving† beyond a certain level of wealth, since each extra £ earned (with a 2% rate of return) would not be sufficient to pay both income tax and wealth tax.

29. The Minister for Finance has recognised that this possibility might arise and accordingly he has stated that some overall limit might [illegible]t on the percentage of income to be taken by income tax and annual wealth tax; if such a limit were set then any consequential abatement of wealth tax would not reduce the wealth tax payable below a certain percentage of the assessed liability.

30. The appropriateness of the proposed exemption thresholds (see paragraph 25 above) must depend *inter alia*, on the assets which are included in the definition of wealth for tax purposes. However, whatever thresholds are fixed, we believe, on the grounds of equity, that the

* This may not be true for agricultural land, when the net return on the land is expressed as a percentage of its current market value. There are, however, special provisions for the valuation of agricultural land.

† The tax system already gives preferential treatment to borrowers as compared to savers. For example, the first £70 of interest on personal savings held as deposits with certain financial institutions is exempt from tax for a single person (£140 for a married couple). Under recent proposals made by the Minister for Finance, interest on borrowed money up to £2,000 would be a deductible expense for income tax purposes. This discrimination against saving and in favour of borrowing is in addition to the transfer of real resources that takes place from savers (who hold their savings in the form of money) to borrowers when prices in general are rising.

exemption threshold for a married couple should be twice that for a single person. If the thresholds proposed for married couples in paragraph 25 above were adhered to and if the tax yield were an important consideration, then the exemption threshold for single persons should be half of that proposed for the married couple.

31. An annual wealth tax creates administrative problems—particularly in relation to valuation. The proposals in the White Paper placed the responsibility of making an annual return of wealth on the taxpayer, with fairly heavy penalties for non-disclosure or evasion. In his address to the C.I.I. on 15 May 1974, the Minister stated that the valuations agreed upon would remain valid for three years. This could create difficulties and cause hardship if the value of the taxable wealth fell during the three-year period. If hardship were to be avoided, taxpayers would need to have the option of substituting actual market value for that initially agreed. However, this would not fully resolve the difficulties. Those whose wealth rose in value over the three-year period would benefit. There could, therefore, be inequities as between different taxpayers and the possibility of economic distortion in the disposition of wealth over different categories of assets could not be ruled out. However, these difficulties may have to be accepted for an initial period following the introduction of the new tax.

32. In-so-far as the taxpayer would of necessity incur compliance costs in meeting the requirements of the tax system, a case can be made for allowing such costs as an expense against tax. If this were accepted, it would be appropriate to place an upper limit on the amount of compliance costs that could be deducted from the tax liability—e.g., deductible compliance costs might be limited to some maximum amount or percentage of the wealth tax liability. Alternatively, any measure which could reduce compliance costs without affecting detrimentally other objectives, such as "horizontal equity", might be considered.

33. The Minister for Finance stated that there were other aspects of the wealth tax which were under particular consideration. One of these related to the most appropriate form of relief for productive capital used in business. The difficulty of defining a suitable code for universal application is compounded by the varying needs of different

industries and businesses—e.g., liquidity problems; borrowing needs; nature of assets; yield on investments; stage of development; private or public ownership, etc. One business might require a substantial stock-in-trade, another considerably fixed capital, and the main assets of another might be in buildings. The Minister for Finance indicated that further discussions would be held with the interests concerned to attempt to identify the main difficulties and problems. Any reliefs which would be given would have to reflect the Government's desire to see capital put to productive use.

V. THE PROPOSALS AS A WHOLE

34. The White Paper proposes the introduction of three new taxes—a capital gains tax, a wealth tax and an acquisitions tax covering both inheritances and gifts *inter vivos*. If all these new taxes were introduced at the same time, serious difficulties and problems could arise both for those administering the new taxes and for those who had to pay them. These would be eased if the introduction of the new taxes was phased over a greater number of years than proposed in the White Paper.

35. The White Paper made it clear that the aim of the new taxes was to make the tax system more equitable and to promote social justice by reducing inequalities of wealth. Less emphasis was given to the importance of ensuring that wealth would be used efficiently to create more real wealth and employment. The White Paper did mention "encouragement to use wealth for productive purposes" (in paragraph 45) and it implied (in paragraph 116) that the new tax structure would cause less liquidity difficulties for small and medium-sized farms or businesses than estate duty.

36. In assessing the broad economic and social implications of any tax system, achieving equity, reducing inequality and promoting greater economic efficiency and growth, are key considerations. In the light of the research that has been done so far in Ireland and of the statistical information that is available, it is not possible to quantify the extent to which the new proposals will improve equity or reduce inequality or make for greater economic efficiency. Moreover, these objectives may be in conflict with each other—a major step towards reducing inequality

in the distribution of wealth may have adverse effects on the rate at which new wealth will be created. If such conflict occurs, people and organisations may reasonably differ in their assessment of how much economic growth should be sacrificed for a more equal distribution of both the stock of wealth and the income generated from its use.

37. We accept (subject to our comments above) that the Minister's proposals will help make the tax system more equitable. Our concern is about the balance between equality and economic efficiency and growth. The White Paper discusses economic efficiency only from the rather limited viewpoint of, for example, the liquidity problems that capital taxes might pose for family firms. It does not discuss economic efficiency in its broader terms—namely, the possible effects of the proposals on the development of agriculture and industry and on the overall growth of national output and employment.

38. The White Paper proposed a relatively heavy annual wealth tax and a light capital acquisitions tax, especially for transfers to spouse and children. The Minister's subsequent amendments to the wealth tax proposals have helped to reduce the weight of the proposed wealth tax. Our suggestions would help to increase the weight of the acquisitions tax. Taken together, these changes should make it easier to set up a new firm, less difficult for an efficient firm to expand and more difficult to retain a business within a family at death, than would have been the case under the White Paper proposals. These changes would, therefore, help to promote economic efficiency. Since the greatest inequalities in the distribution of wealth result from differences in inherited wealth, our suggestions relating to the acquisitions tax should also help to reduce inequality. The trend towards greater equality would also be strengthened if, as we have recommended, the acquisitions tax were widened as soon as feasible to become an accessions tax.

Addendum by representatives of Irish Congress of Trade Unions

The representatives of the Irish Congress of Trade Unions on the Council support in general the comments in Sections II–V subject to the following reservations:

Capital Gains Tax

A.1. The proposals should be expanded to cover unrealised capital gains, calculated on the basis of, say, five-yearly valuations.

A.2. Short-term capital gains should be taxed at a higher rate than long-term capital gains.

A.3. We reject the modification to the White Paper proposals announced by the Minister for Finance on 15 May 1974, reducing the rate of capital gains tax from 35% to 26%. Persons liable for capital gains tax will be paying income tax on their taxable income at the rate of at least 35%. There is no reason why their capital gains tax liability should be assessed at a lower rate.

Capital Acquisitions Tax

A.4. We regard the threshold for exemption, particularly for spouses and children, as too high, even when the Council's suggested changes are taken into account.

A.5. We do not accept the arguments in favour of a lower rate of tax being charged on gifts than on inheritances and consider that the same tax rate should be applied to both.

Annual Wealth Tax

A.6. We reject the modification in the rates of wealth tax and the increases in the exemption thresholds announced by the Minister for Finance on 15 May 1974 and consider that the White Paper proposals should be maintained.

The Proposals as a whole

A.7. The stated objectives of the White Paper on Capital Taxation were the achievement of greater equality in wealth distribution and the sharing of the tax load. In fact, the original proposals would have made a very limited contribution to the achievement of these objectives, since the yield of the capital taxes was officially estimated at only £12–13 million, the same yield as the present estate duties.[1] It follows that the reduction in the rates of capital gains tax and wealth tax together with the other modifications of the White Paper proposals announced by the Minister for Finance on 15 May will produce an even smaller revenue.

A.8. In the 1974 Budget the rate of tax on investment income was effectively reduced, and the income tax liability in respect of high incomes was reduced significantly. In his announcement of 15 May, the Minister indicated his intention of reducing the top rate of income tax by 10 percentage points and reductions in the effective rate of tax borne by other high salaries. (Though these changes were stated to be in the context of the introduction of an annual wealth tax, they will apply even where there is no liability to wealth tax.) These tax concessions to persons in the high-income brackets reinforce the arguments in favour of the restoration of the rates of capital gains tax and wealth tax to the levels proposed in the White Paper. Otherwise the effect of the new taxation proposals would be a redistribution of the burden of direct taxation from the wealthy to wage and salary earners. This is completely unacceptable.

A.9. The Minister for Finance has described the proposal to review regularly the thresholds for capital tax purposes as follows:

> "This statutory obligation on the Revenue Commissioners to compensate a taxpayer for inflation will be quite revolutionary in tax laws in Ireland."[2]

Congress representatives would not accept the application on a statutory basis of this excellent principle to capital taxes only. Indeed, we would reject its introduction in respect of such taxes unless it applied equally to the personal income tax system.

[1]Minister for Finance addressing a Fine Gael, Dublin Central, meeting: 29 April 1974.
[2]Minister for Finance addressing the Junior Chamber Ireland, Westport: 28 April 1974.

A.10. The Minister for Finance has stated that under the White Paper proposals "only a relatively small number—about 500 quite wealthy people—will be financially disadvantaged"[3] and that as a result of the capital taxation reform 80,000 of the 90,000 now alive who are at risk to pay estate duty, and their families "are being relieved of all estate duty and will not have to pay wealth taxes". These statements were made before the modifications of the capital taxation proposals announced on 15 May, which reduced the proposed rate of capital gains tax by a quarter and the proposed rate of wealth tax by a third and which raised the thresholds and gave numerous reliefs. We note the estimate made by Sean D. Barrett, lecturer in economics, Trinity College, Dublin that the changes announced on 15 May meant that "the Minister has given £4m. to the richest groups in the country", and his conclusion that the capital taxation proposals "will make no difference to 98% of taxpayers, except, on present trends, to increase their tax bill".

A.11. Congress representatives are opposed to the suggestion by the Council that the introduction of the new taxes might be phased over a greater number of years than proposed in the White Paper.

[3]*The Irish Times*: 17 May 1974.

PART II: COMMENTS ON TAXATION OF FARM INCOME

1. In his Financial Statement, the Minister for Finance stated that consultations would be held with the National Economic and Social Council on considerations to be borne in mind in the taxation of farm profits. The Council's comments as agreed at its meeting on 16 May 1974, are set out in the following paragraphs.

2. There was agreement in principle that all sections of the community (including farmers) should make their fair contribution to tax revenue. There was no agreement on whether £100 or a lower poor-law valuation should be the starting point for the detailed application of the present proposals.

3. As regards the proposed notional basis of assessment, there seemed to be general agreement that rateable valuation of farm land was not necessarily correlated with farm income. The argument in favour of using rateable valuation was that all land had a rateable valuation, and that at present it was the only basis for a rough and ready measure of income. Actual farm accounts would be more equitable and relevant. If actual accounts were to be used, some time could elapse before they were generally available. In essence, income tax is a tax based on capacity to pay as measured by income.

4. Where actual accounts were used as the basis for assessment, there might be a case for some relief from income tax in respect of rates on agricultural land. This is based on the assumption that for larger farmers rates constitute a significantly larger proportion of income than is the case in other business enterprises.

5. If actual farm accounts were used as the basis for assessment, some adaptation of the present system of tax reliefs, which were primarily

geared towards non-agricultural activities, would be required. Allowances could be determined or adjusted to encourage investment in sound agricultural development.

6. There was disagreement on the "multiplier" of 40 mentioned in the Minister for Finance's proposals. If this notional basis is to be maintained for other than a transitional period, the Council would welcome the opportunity of examining the basis on which a more equitable notional assessment might best be made.

7. There was general agreement that, where farmers were assessed on the basis of actual accounts, some provision would be desirable whereby the average income over a number of years could be taken for assessment rather than the income in a single tax year.

8. There was general agreement that, where income from agriculture was not assessable for tax, it should not be permissible to offset losses arising from agriculture for tax purposes against income arising from outside agriculture.

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