

National University of Ireland, Galway
Ollscoil na bÉireann, Gaillimh

Fantasy Budget 2009

Sinead Geraghty

Aileen Maloney

Claire McDermott

Helen Walsh

Table of Contents

- 1. Introduction.....3
- 2. Foreign Income Tax Exemption.....3
- 3. Re-introduction of Third Level Fees.....6
- 4. Reduction in the CGT rate.....9
- 5. Aviation Emissions Charge.....12
- 6. Conclusion.....14
- 7. Appendix A- Worked example of Emissions Charge..... 15
- 8. Bibliography
 - References for Foreign Income Tax Exemption.....16
 - References for Re-introduction of Third Level Fees.....16
 - References for Reduction in the CGT Rate.....18
 - References for the Aviation Emission Charge.....19
 - References for Appendix A.....19



1. Introduction

The four policy initiatives we have chosen to outline in our fantasy budget are:

- A foreign income tax exemption
 - The re-introduction of third level fees
 - A cut in the rate of capital gains tax
-
- The introduction of an aviation emissions tax.

2. Foreign Income Tax Exemption

As one of his presidential campaign policies, Barack Obama said that he would work to bring American jobs back to America. This has caused much worry in Ireland due to our reliance on foreign direct investment (FDI) for jobs in companies such as Medtronic and Intel.

We propose to give a tax exemption on the Case III (foreign income) tax liability to companies who enter foreign markets in 2009 and 2010 to the extent that in those years this liability does not exceed €125,000. This proposal aims to encourage the growth of Irish firms, working towards less reliance on the jobs offered by the FDI companies in Ireland.

This measure will be available to companies who are resident in Ireland. The companies must also have been set up in Ireland, have paid Irish corporation tax for the previous five years and must not intend to wind up within five years of receiving the exemption unless it is for bona fide commercial reasons (Enterprise Ireland, 2008).



Ireland has a small economy and so it is hoped that this incentive will encourage the larger Irish firms to take the opportunity to expand their businesses and to take advantage of the larger European market.

By doing this companies will generate additional foreign income in the future which will lead to larger profit and therefore a larger tax liability. This tax exemption will also ensure that these newly expanded businesses will have more finance for reinvestment meaning that the long term future of the firm will be more secure.

Ireland enjoyed unprecedented economic success during the Celtic Tiger. However, it is widely accepted that this growth has now reversed. O'Brien (2008), in the Irish Times, reported that "In September, the Live register figures hit their highest level in almost 10 years, with an extra 80,000 people signing on compared to a year earlier." Increased commercial security of firms will result in greater job security in their Irish operations. This may repress the growth in the unemployment rate.

As part of the Budget 2009, Brian Lenihan plans to introduce a three year tax exemption for start-up companies (Rep. Ireland. Department of Finance, 2008). This proposal will incentivize start up businesses. However, we feel that we need to give incentives to our existing firms to expand. Our proposal links in with this by encouraging the larger Irish firms to innovate and grow into foreign markets. Similar to the proposal put forward in the Budget by Brian Lenihan, our proposal would need to be examined to ensure it is in compliance with EU rules on state-aid.

3. Re-introduction of Third Level Fees

We propose that third level students should pay for their own tuition fees. A system similar to the UK should be adopted where tuition fees are payable from a student's future income. The burden of payment would so shift to those who directly benefit.



Originally, free fees were introduced to benefit lower income brackets. Many low income students were covered by the grant system making middle class students the main benefactors. The OECD survey (2006) cites Harmon and Sheehan (2004) as saying that the equality of access desired has not been achieved.

There is a fear that reintroducing fees may provide disincentives to those on lower income from entering third level education. The OECD survey (2006) found that this wasn't the case in New Zealand and the UK. Future potential income increases with a third-level qualification, thus it shouldn't create a barrier to entry. Marks (2001) assessed the attitudes of students towards the possibility of introducing fees in UK in the nineties. He found an introduction of fees wouldn't stop school leaving students from enrolling in third level education.

The OECD survey (2006) shows that resource allocation within a college

improves and that the college becomes more responsive to students needs. Therefore the cost to society is lower and the system fairer.

Our proposed payment system creates an incentive for students to choose their course carefully. They will value their education more and gain higher returns from education. The system is fairer as lower income tax payers are not paying for others to obtain third level education.

There has been a considerable reduction in funding for educational councils and committees which may potentially reduce service quality.¹ At third level, there is an increase in registration fees to €1,500. However, An Taoiseach, Brian Cowen did announce €79 million more investment in capital projects such as school buildings. (Rep. Ireland. Department of Finance, 2008).

The college registration fee is intended to cover the administrative costs incurred during an academic year yet the proposed increase will flow to the government, not colleges. This is an inefficient approach and regressive in terms of those marginally above the tax cut off rate.

Minister O’Keefe (2008) recognizes that ‘the resources available to me next year mean that difficult choices had to be made in order to try to meet the full range of needs in the

¹ They’ve re-organized councils, consolidated resources and abolished committees e.g. educational disadvantage committee.
A proportion of grants worth 26million have been reconsidered.

education sector'. This spending constraint gives further basis for the need for a more equitable spread of funds put forward by our proposal.

The Irish education system is under-funded by OECD standards (OECD, 2006). The cash-flow generated from our proposed scheme could be funded into the recently abandoned councils mentioned above and could be allocated across all educational levels improving resources and facilities.

If Ireland hopes to maintain itself as a knowledge economy, measures such as ours need to be taken.

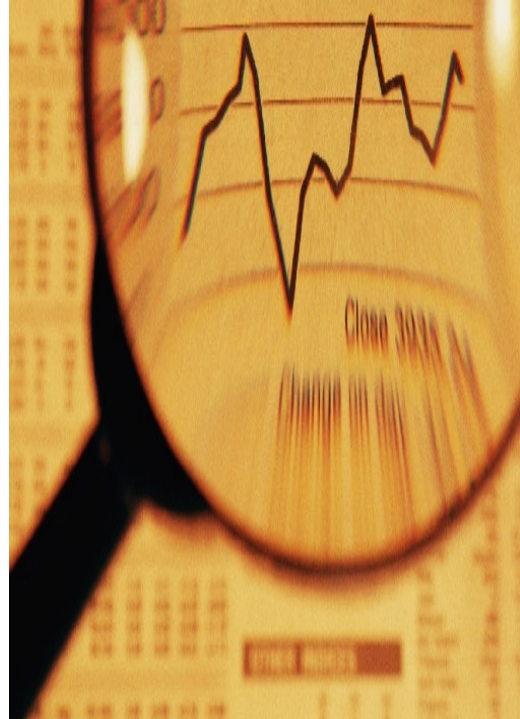
4. A Reduction in the CGT rate

We propose a 5% percent cut in the rate of capital gains tax (CGT) from 20% to 15%, effective from the date of announcement.

Historical and empirical evidence have shown an inverse relationship between CGT rates and tax revenue. Upon halving the CGT rate from 40% in 1998 to 20% in 1999, Irish CGT

receipts rose from £194,583 to £357,519 (Rep. Ireland. Department of Finance, 1999).

Similarly in the U.S.A., cuts in the CGT rates in 1978 and 1981 resulted in increased revenues while an increase in the rate in 1987 saw a fall in tax revenues (U.S.A. Joint Economic Committee Study, 1997). According to Authen (1991), numerous empirical studies have been carried out, all of which find some level of evidence in support of this relationship. Testifying before the American Senate Finance Committee on March 13, 1997, economist Allen Sinai outlined what he felt the effects of a CGT reduction would be (U.S.A. Joint Economic Committee Study, 1997). He found a reduction would decrease cost of capital, boost investment and stimulate economic growth, all of which could only benefit the Irish economy at this time.



As a result of the current Irish economic climate, unemployment is rising and the lure for innovation/entrepreneurship is staggered by uncertainty. According to Brian Cowen, then Minister for Finance, in the 2008 Budget Speech (Rep. Ireland. Department of Finance, 2007), the business community are “wealth creators and generators of employment in this country”. CGT, however, can be thought to discourage risk taking and capital investment and consequently diminish entrepreneurial activity such as job creation, innovation and productivity. We believe a CGT reduction, through increasing possible after-tax returns, would create incentives for investment in businesses and encourage innovation.

Recently, a lack of confidence in Irish companies has left a shortage of buyers on the Irish Stock Exchange. We feel a reduction in the CGT rate would help boost asset prices so investors feel confident buying again. According to Lang & Shackelford (2000), where a stock’s returns are subject to CGT, a cut in the CGT rate will make stock more attractive to investors. By enticing investors back to the market, the potential exists for a fall in the rate of deterioration of ISEQ shares.

As part of Budget 2009, Brian Lenihan announced an increase on the CGT rate from 20% to 22% (Rep. Ireland. Department of Finance, 2008). Considering the recent fall in the market value of shares and property it is difficult to understand from where the Government feels any extra CGT revenue will come (Ryan, 2008). Conversely, under our proposal, while the receipts per gain will be lower, the volume of gains should be higher. Paired with the positive macroeconomic effects discussed above, we believe our proposal has potentially greater value adding attributes.

Also as part of the 2009 Budget, Brian Lenihan announced that for 3 years following commencement, start-up companies will be exempt from tax (including CGT), provided their annual liability does not exceed €40,000 (Rep. Ireland. Department of Finance, 2008). Provided it receives EU ratification, this will be of significant advantage to new businesses. This has obvious advantages over our proposal in terms of encouraging innovation given they will be subject to no tax instead of reduced CGT. Our proposal does, however, have potential long term advantages if the reduction was to be maintained in the future. The budget proposal, depending on the final terms, may also unintentionally allow for existing businesses to restructure and avail of the exemption. Our proposal does not have this problem.

5. Aviation Emissions Charge

We propose the introduction of an emissions linked charge on every commercial flight that departs the Republic of Ireland.



We advise charging the two primary aviation emissions: carbon dioxide and nitrogen oxide. (Appendix A) We advise a charge of €0.4 per kg of emissions, which will result in an increase in flight prices of 10.47%¹. In our opinion, an increase of this size is feasible to expect of customers, who are likely to bear the full cost of the charge².

We believe that implementation of this policy would have the following benefits for Ireland:

- Greatly increasing government revenue. We feel that this benefit is highly important, given the current economic climate.
- Motivating airlines to use newer, “greener” aircraft, which will decrease air pollution.

¹ based on the price of €637.91 as averaged over 7 economy class flights from London to New York on <http://www.netflights.com/flights/farelist.asp> as compared with our emissions charge per customer calculated in Appendix A. Prices were translated from sterling to euro on 12 November 2008

² given the trends in flight prices for price itemization

- Promoting airlines to invest in R&D in developing “green technologies” and to become generally more efficient. This may result in tenders for Irish university science or engineering students, and will promote innovation.
- Encouraging former fliers to switch to greener forms of transport, such as rail and ferry. Carbon awareness will be promoted among Irish citizens, which may lead to a much needed reduction of our overall carbon emissions¹.

In our opinion, an emissions charge is the most effective way of reducing aviation pollution. Budget 2009 introduced a €10 tax on all flights departing Ireland. Presumably, this measure was introduced because of environmental as well as revenue generating reasons.

This measure is not efficient. Presuming that the charge is passed on in flight prices, the same burden of the tax falls on all customers regardless of the emissions of the flight chosen. The €10 levy also does nothing to promote emission reduction by airlines. In contrast, our emissions charge is efficient - the heaviest tax burden falls on those that are responsible for the most emissions produced². Our policy is also equitable. The more affluent are more likely to travel long distance and so pay a higher emissions charge. Thus, the rich will pay more tax than the poor.

¹ As measured by the Kyoto Agreement, Ireland does not meet its present requirements for carbon emission reductions(<http://www.change.ie/en/Whats-being-done/National-Level/>, no date)

² assuming emissions charge is passed on in flight prices

6. Conclusion

We are aware of the difficulties facing the Government in having to raise a substantial amount of revenue through Budget 2009. However, we feel that in certain initiatives they failed to live up to Adam Smith's Four Canons of Taxation;

- Convenience
- Certainty
- Equality
- Economic Efficiency.

As outlined in the above sections, we feel our initiatives better comply with the Canons on the issues we have addressed.

7. Appendix A

Worked Example of Emissions Charge:

Carbon Dioxide Emissions: Calculated as 1 kg per kg of fuel used (Brockhagen and Lienemeyer, 1999)

Nitrogen Oxide Emissions: This is calculated by reference to the nitrogen emissions index (Schumman, 1997), which is multiplied by the amount of fuel consumed. The index incorporates the model of aircraft and the distance covered during the flight.

EXAMPLE: Boeing 747-400, consuming 57,000kgs of fuel flying London to New York:

57,000 x 1kg: 57,000kg carbon dioxide emissions

57,000 x 0.0143kg: 815.1kg nitrogen oxide emissions

Total emissions: 57,815.1 kg

Total charge: €23,126 (57,815.1 x €0.04)

Charge per customer: €74.60¹

(Whitelegg and Williams, 2000)

¹ assuming flight is full with 310 passengers

8. Bibliography

8.1 References for Foreign Income Tax Exemption

Enterprise Ireland (2008) *Business Expansion Scheme* [Online]. Available at:

http://www.enterprise-ireland.com/Grow/Finance/Business_Expansion_Scheme.htm

(Accessed 13 November 2008).

O'Brien, C. (2008) 'More than 32,000 jobs lost in 2008', *The Irish Times*, 3 November [Online]. Available at:

<http://www.irishtimes.com/newspaper/breaking/2008/1103/breaking68.htm> (Accessed:

12 November 2008).

Rep. Ireland. Department of Finance (2008). *Budget 09* [Online]. Available at:

<http://www.budget.gov.ie/> (Accessed 7 November 2008).

8.2 References for The Re-Introduction of Third Level Fees

Marks, A. (2001) 'Unraveling of a Sector: does the introduction of fees spell the end of education for all?', *Journal of Further and Higher Education* [Online]. Unavailable at:

www.informaworld.com/smpp/834421209-8273331/title~content=g713430716~db=all

(Accessed 10 November 2008).

OECD Economic Surveys – Ireland (2006), *Economic Survey of Ireland 2006: Investing in skills*, Full Text [Online]. Available at:

http://www.oecd.org/document/3/0,3343,en_33873108_33873500_36172739_1_1_1_1,0.html (Accessed 11 November 2008).

OECD Economic Surveys- Ireland (2006), *Organisation for Economic Co-operation and Development*, volume 2006 (3). [Online]. Available at:

<http://titania.sourceoecd.org/vl=1262140/cl=16/nw=1/rpsv/~3805/v2006n3/s1/p11>

(Accessed 10 November 2008)

O’Keefe, B. (2008) *Minister outlines key Budget measures for Education in 'difficult economic times'* [Press Release]. 14 October. Available at:

<http://www.education.ie/home/home.jsp?maincat=&pcategory=10861&ecategory=10876§ionpage=12251&language=EN&link=link001&page=1&doc=42252> (Accessed: 10

November 2008).

Rep. Ireland. Department of Finance (2008). *Budget 09* [Online]. Available at:

<http://www.budget.gov.ie/> (Accessed 20 November 2008).

8.3 References for Reduction in the CGT Rate

Authun, G.E. (1991) 'Cutting Capital gains taxes: policy watch', *Journal of economic perspectives*, winter 5(1), pp. 181-192. [Online]. Available at: www.ebscohost.com (Accessed: 7 November 2008).

Lang, M.H. & Shackelford, D.A. (2000) 'Capitalization of capital gains taxes: evidence from stock price reactions to the 1997 rate reduction', *Journal of Public Economics*, 76 pp. 69–85 [Online]. Available at: www.ebscohost.com (Accessed 7 November 2008).

Rep. Ireland. Department of Finance (2007). *Budget 08* [Online]. Available at: <http://www.budget.gov.ie/2008/default.html> (Accessed 7 November 2008).

Rep. Ireland. Department of Finance (2008). *Budget 09* [Online]. Available at: <http://www.budget.gov.ie/> (Accessed 7 November 2008).

Rep. Ireland. Department of Finance (1999). *Statement of Exchequer Surplus (deficit) in the period ended 31 December 1999* [Online] Available at: <http://www.finance.gov.ie/viewdoc.asp?DocID=2641> (Accessed: 7 November 2008).

Ryan, J. (2008) 'What does Budget 2009 have in store', Sunday Business Post, 5 October [Online]. Available at: <http://archives.tcm.ie/businesspost/2008/10/05/story36420.asp> (Accessed 8 November 2008).

U.S.A., Joint Economic Committee Study (1997). *The Economic Effects of Capital Gains Tax* [Online] Available at: <http://www.house.gov/jec/fiscal/tx-grwth/capgain/capgain.htm> (Accessed: 6 November 2008).

8.4 References for the Aviation Emissions Charge

Rep. Ireland. Department of Finance (2008), *Budget 09* [Online]. Available at: www.budget.gov.ie (Accessed 1 November 2008).

<http://www.change.ie/en/Whats-being-done/National-Level/> (no date) (Accessed 4 November 2008).

<http://www.netflights.com/flights/farelist.asp> (no date) (accessed 6 November 2008).

8.5 References for Appendix A

Whitelegg, J., Williams, N., (2000) *The Plane Truth : Aviation and the Environment*. [Online]. Available at: <http://www.areco.org/planet.pdf> (Accessed 1 November 2008).

Brockhagen, D., Lienemeyer, M., (1999) *Proposal for a European Aviation Charge: Design and Implementation with respect to International Economical, Ecological, Legal and Political Constraints*, unpublished research report. Referenced from Whitelegg, J., Williams, N., (2000) *The Plane Truth : Aviation and the Environment*. [Online]. Available at: <http://www.areco.org/planetr.pdf> (Accessed 1 November 2008).

Schumann, U. (1996) 'The impact of nitrogen oxides emissions from aircraft upon the atmosphere at flight altitudes—results from the aeronox project', *Atmospheric Environment*, 31 (12), pp. 1723-1733 [Online]. Available at: www.sciencedirect.com (Accessed: 3 November 2008).