11 Household and business manager: Taxation

Learning objectives

In this chapter you will learn about:

1. Taxes on households and on businesses
2. PAYE and how it is calculated

Taxation

Taxation refers to monies collected by the government from people and from businesses, which it spends on running the country and on the provision of services. The tax office is also known as the **Revenue Commissioners**.

Taxes paid by households

- Capital acquisitions tax
- Capital gains tax
- Deposit Interest Retention Tax (DIRT)
- Motor tax
- Pay As You Earn (PAYE) income tax
- Self-assessment income tax
- Value Added Tax (VAT)

How the PAYE income tax system works

- The tax year commences on 1 January each year.
- Each employee must pay tax from the wages or salary they earn. The amount of tax due is calculated by the employer and deducted from the employee's pay along with the employee's PRSI contributions.
- The government gives reductions in the amount of tax payable by each person, called **tax credits**. The amount of tax credits a person gets depends on each person's personal circumstances.
- Each employee is given a **standard rate cut-off point** by the tax office. This is the amount of income that is taxed at the standard rate of tax (the standard rate of tax in 2014 was 20%).
- Any income earned over the standard rate cut-off point will be taxed at the higher rate of tax (the higher rate of tax in 2014 was 41%).
- The **Universal Social Charge** is an additional tax calculated on gross income at 2% on first €10,000, 4% on the next €6,000 and 7% on any balance of income (2014).
- The operation of the PAYE system involves the Revenue Commissioners, employers and employees in keeping detailed records and completing a number of important forms (Form P12, P60, P45 and P21) that are used to operate the system efficiently.

Taxation forms

Form P12

A form completed by the taxpayer showing their income earned and the tax credits they are claiming for the next year. Using this information the tax office will update the person's tax credits and standard rate cut-off point.

Form P60

This form is issued at the end of the tax year by the employer to the employee showing income earned and the amounts of tax and PRSI paid.

Form P45

This form is given by the employer to the employee when they leave their job. It shows income earned and amounts of tax deducted in the tax year so far. This form is given to a new employer to allow them to calculate the new employee's tax.

Form P21

This form is issued by the Revenue Commissioner to the taxpayer at the end of the tax year. It shows the amount of tax paid and also the amount that should have been paid. Underpaid tax will have to be paid and overpaid tax will be refunded to the taxpayer.

Questions

Sample tax calculation question and sample answer

John Mayall has a gross salary of €42,100 per annum. His PRSI contributions are 4% of gross income. His universal social charge (USC) is 2% on the first €10,000, 4% on the next €6,000 and 7% on the balance of his income. His tax credits total €2,360. His standard rate of tax is 20% and higher rate is 41%. The standard rate cut-off point is €32,800.

Calculate (a) PRSI (b) USC (c) the tax he must pay (d) his net take home pay.

Sample Answer

Solution

(a)

PRSI €42,100 @ 4% = €1,684

PRSI €1,684

(b) USC alculation

€10,000 @ 2% = €200

€6,000 @ 4% = €240

€26,100 @ 7% = €1,827

USC €2,267

(c) Tax calculation

€32,800 @ 20% = €6,560

€9,300 @ 41% = €3,813

Gross tax €10,373

Tax credits = €2,360

Tax payable = €8,013

(d) Calculation of net take home pay

Gross pay €42,100

Tax payable €8,013

PRSI €1,684

USC €2,267

Total deductions €11,964

Net pay €30,136

Taxes paid by businesses

- Capital gains tax
- Commercial rates
- Corporation profits tax
- Customs duties/import taxes
- Income tax: Pay As You Earn (PAYE)
- Motor tax
- Pay Related Social Insurance (PRSI)
- Value Added Tax (VAT)

Top Tip!

You should be able to calculate PRSI, USC, PAYE and net pay.

Corporation profits tax

All businesses must pay this tax on their profits at 12.5% (2014) each year. Ireland's tax rate is lower than many other countries and it attracts firms to set up in this country.

PAYE – Income tax

Every business must collect this tax on its employee's income for the government. This involves calculating tax due, keeping full records and returning the tax collected to the Revenue Commissioners.

Value Added Tax (VAT)

Value Added Tax is a tax on the sale of goods which is paid by the consumer. Businesses must collect this tax for the government. To do this the firm records the VAT it collects on its sales and also the VAT that it pays on its purchases. Every two months they make a VAT return sending net VAT collected to the Revenue Commissioners. VAT must be shown on all invoices and full records must be kept. Different VAT rates apply to different goods and services.

How taxation affects a business

Firms are **unpaid tax collectors** for the government in the case of VAT and PAYE.

The work associated with administering the full range of taxes costs a lot and **reduces profits.**

Corporation Profits Tax takes away a percentage of the **profits** earned by the firm. Some firms locate their business based on the rates of tax they will have to pay in different countries.

Taxes such as PRSI are a real cost for a business and push up their **wage-related costs.**

Taxes on imported materials such as **customs duties** increase the **production costs** of firms.

The collection and payment of taxes puts pressure on firms in the **management of cash flows.**

Any decisions of a business must take into account the tax implications, which can have a big influence. The overall demand in the market goes down if the level of taxes in the economy is high. This will have a negative effect on sales and profits

Exam question

1 Pay As You Earn (PAYE), Value Added (VAT) and Corporation Tax are examples of taxes relevant to a business.

(i) Explain each tax above.

(ii) Evaluate the implications of each tax for a business. *(2011, 25 marks)*

Sample answer

(i)

Pay As You Earn

PAYE is a direct tax on income earned from employment.

PAYE is remitted by the business every month to the Revenue Commissioners.

It is deducted at source by the employer and passed on to the Revenue Commissioners.

Taxpayers receive a certificate of tax credits, which is forwarded to employers and which will reduce the amount of tax they have to pay.

Value Added Tax

VAT is an indirect tax charged on the sale of goods and services.

VAT is remitted by the business every two months to the revenue commissioners.

VAT is charged at different rates, depending on the type of goods or services involved.

The collection of VAT is a significant administrative cost for business.

High rates of VAT increase the purchase price for consumers. This reduces the demand for goods and services of business.

Corporation tax

Corporation tax is a tax on the profits made by companies.

Expenses of the business are allowable when calculating the taxable profits of the business.

Companies must prepare annual final accounts to show their taxable profit.

Corporation tax in Ireland is relatively low by international standards. This encourages Irish entrepreneurs and foreign investors to set up business here.

Corporation tax reduces the size of profits and consequently the amount available as retained earnings.

(ii)

Pay As You Earn

The collection of PAYE is an administrative cost for business. It is a bureaucratic system requiring the completion of many different taxation forms, e.g. P12, P60, P45, and P21.

High rates of PAYE are a disincentive for people to do overtime, which affects a business's ability to meet sales orders.

Marking scheme

- Explain three taxes: 3 x 5 marks
- Implications of tax: 1 x 4 marks + 2 x 3 marks

Questions

1 From the following information, calculate the net annual take-home pay of Ms Joan McCormack.

Joan McCormack is an employee of Lynch Printers Ltd and earns a gross annual salary of €84,000. She is allowed the following tax credits: Single Person credit of €1,760 and PAYE credit of €1,760. The income tax rates are: 20% on the first €34,000 (standard rate cut-off point) and 41% on the balance. The employee PRSI rate is 4% of gross income. The universal social charge is 2% on the first €10,000 earned, 4% on the next €6,000 and 7% on the balance. *(2007, Question 5 (adapted), 20 marks)*

2 Contrast the tasks of managing taxation in a household and managing taxation in a business.

3 Distinguish between the following taxation forms: Form P21 and Form P60.

(2007, 20 marks)

Key-points!

- How to calculate PAYE tax
- Taxes to be paid by households and businesses
- How taxation affects business

Key-definitions!

Deposit Interest Retention Tax (DIRT): A tax on the interest earned by money on deposit. Interest must be collected by the bank and paid to the Revenue Commissioners.

Pay As You Earn (PAYE) income tax: An income tax paid by all employees. It is calculated by the employer, deducted from wages and paid over to the Revenue Commissioners.

Pay Related Social Insurance (PRSI): An insurance scheme operated by the government to provide unemployment benefits, maternity benefits and pensions to workers.

standard rate cut-off point: The amount of a person's income which is subject to the standard rate of income tax.

tax credits: Reductions in the amount of tax payable by each individual. The amount allowed by the tax office depends on the circumstances of each tax payer.

Value Added Tax (VAT): A tax on the sale of goods and services that is paid by the consumer. The tax is collected for the Revenue Commissioners by businesses.