Chapter 13: Increasing Social Insurance Fund (SIF) Income

13.1. Background

Revenue raising measures are one of the principal policy options that can be used to improve the sustainability of the SIF and the State Pension system. This chapter focuses on increasing SIF income in two main ways, through raising PRSI rates and base broadening measures.

In relation to increasing PRSI rates, the Commission specifically looked at increasing Class S PRSI (self-employed) and increasing Class A PRSI (employer and employee).

In relation to base broadening options the Commission specifically looked at:

- Removing the exemption whereby people of State Pension age (age 66) and older do not pay PRSI on their income, and
- Removing the exemption from paying PRSI on supplementary pension income (which applies to people regardless of age).

This chapter considers each of these options in turn.

The *Programme for Government* (2020) states that, "Consideration will be given to increasing all classes of PRSI over time to replenish the Social Insurance Fund to help pay for measures and changes to be agreed including, inter alia, to the State Pension system, improvements to short-term sick pay benefits, parental leave benefits, pay-related jobseekers benefit and treatment benefits (medical, dental, optical, hearing)."

13.2. Class S PRSI (self-employed)

13.2.1. Current situation

Class S PRSI for self-employed people was introduced in 1988. Class S PRSI is paid on both earned (e.g. self-employment/farming) and unearned income (e.g. income from investments, rents or maintenance payments). At the end of 2019 there were over 351,000 Class S contributors (DSP, 2021).

All self-employed people (ages 16 - 65) with earnings of more than €5,000 a year must pay PRSI.[30] This PRSI contribution is either 4 per cent of reckonable income, or an annual minimum charge of €500, whichever is greater. It is notable that the effect of this formula is that low paid self-employed workers pay 10 per cent PRSI which reduces, in percentage terms to 4 per cent as earnings increase – which is the direct opposite to the PRSI arrangements for low paid employees. For a full list of PRSI classes and benefits see Appendix 3C.

In 2019 Class S PRSI raised €631 million in SIF income. This is equivalent to 5.1 per cent of total 2019 SIF income. In 2020 Class S PRSI raised €647 million in SIF income. This is equivalent to 5.7 per cent of total 2020 SIF income (DSP, 2021).

13.2.2. Considerations

Class S PRSI rates for the self-employed have long been recognised as being disproportionately low for the social insurance benefits received, especially when compared to other workers. While the range of benefits that the self-employed could access was more limited in the past, there has been an extensive expansion in recent years (to include cover for Invalidity Pension and Treatment Benefit in 2017, a Jobseeker's Benefit scheme for the self-employed in 2019 and the Enhanced COVID-19 Illness Benefit payment in 2020) without any increase in the 4 per cent contribution rate. In this regard, self-employed contributors are now covered for most of the benefits available under the social insurance system, with access to 93 per cent of the value of all available benefits.[31]

[30] Employees who are also self-employed in a trade or profession pay Class S PRSI on their self-employment income as well as Class A PRSI on their income as an employee.
[31] The self-employed are currently not covered for the Carer's Benefit, Illness Benefit and Occupational Injuries Benefit schemes.

To put the PRSI rate paid by self-employed contributors into context, a comparison with the rate applying to employed contributors is illustrative. In general, a combined PRSI rate of 15.05 per cent is paid in respect of most employees under PRSI Class A. This includes a 1 per cent contribution to the National Training Fund. The Class A PRSI charge comprises 4 per cent payable by employees and 11.05 per cent by their employer (there is an 8.8 per cent employer PRSI rate, inclusive of the National Training Fund contribution, where weekly earnings do not exceed €395).

In effect, self-employed contributors, in return for a contribution 10.05 percentage points lower than that made in respect of employed contributors, have access to almost all of the benefits available to employed contributors.

The difference in value received from PRSI contributions between Class S and Class A contributors has been noted in a number of reports by a range of bodies:

- A 2009 Commission on Taxation report recommended that, "A similar PRSI base should apply to employees and the self-employed and there should be a single rate of charge which should apply to both." (Government of Ireland, 2009).
- The Advisory Group on Tax and Welfare's 2013 report, *Extending Social Insurance Coverage for the Self-Employed*, published prior to the extension of benefits to the self-employed stated that, "…it is clear that this group [self-employed workers] are already paying low contribution rates for their current range of benefits." The Report recommended the extension of a range of social insurance benefits to the self-employed, with commensurate increases in the relevant social insurance contribution rate.
- The 2015 *Actuarial Review* found that, for a self-employed person on average earnings, their Class S PRSI rate of 4 per cent was 11.8 percentage points below the rate of PRSI that would be needed to pay for a full State Pension (the equivalent figure for an employee is 2.5 percentage point below the required rate of PRSI). (KPMG, 2017).
- In 2016, prior to the extension of a range of social insurance benefits to the self-employed, a DEASP survey of 3,000 self-employed Class S contributors found that a large majority (88 per cent) said they would be willing to pay more PRSI in return for access to more benefits (DEASP, 2019).
- A DEASP paper for the Department of Finance's Tax Strategy Group in 2019 proposed that consideration be given to adjusting the level of social insurance contributions for self-employed workers to that of an employer. The paper suggested, "Changing the basis for the self-employed rate from that of employee to that of employer. The basis for charging a lower rate for self employed workers is that it would be unfair to charge them both an employer and an employee contribution simply because they perform both roles. However, even if this is accepted, it raises the question as to the basis for assessment – that of employee (as at present) or that of employer? Given the extension of benefits, the willingness of self-employed people to pay an additional contribution (from a survey carried out by the Department) and the findings of the report on the use of intermediary-type structures and self-employment arrangements it is believed that consideration should be given to charging self-employed people the employer rate of PRSI." (DEASP, 2019). In parallel with any increase in the underlying contribution rates the DEASP paper proposed that the outstanding social insurance benefits – Illness Benefit and Carer's Benefit – not currently available to self-employed contributors be extended to them. The *Actuarial Review* estimated that this would give rise to an annual cost of about €80 million (KPMG, 2017).
- In 2020 NESC noted that Class S contributors get better value from the PRSI system than those in Class A due to the different rate of contribution paid by each class and proposed that the PRSI contribution of the self-employed be increased to reflect the benefits they are now eligible to receive (McGauran, 2020).

- In 2021 the ESRI calculated that due to employer PRSI, there is an additional €4,420 tax (PRSI, income tax, and USC) burden associated with an employee annual income of €40,000 compared to a self-employed worker with the same level of income (Kakoulidou et al., 2021).
- In response to the Commission's public consultation process, several organisations recommended that the Class S PRSI rate should be increased, or they highlighted the gap between Class A and Class S rates of PRSI.

While the vast majority of self-employment is genuine, the difference between Class A and Class S PRSI rates can contribute to bogus self-employment (i.e. incorrectly classifying an employee as self-employed in order to evade paying the correct rate of PRSI). NESC noted that, "It has also been suggested that a single rate of PRSI contribution should apply to both employees and the self-employed, to help reduce any incentive to try to avoid paying higher employee PRSI contributions." (McGauran, 2020). In addition, the ESRI has stated that, "While many self-employed are involved in 'entrepreneurial activities' such as employing others, innovating and investing, those operating as self-employed include everyone from taxi-drivers to IT consultants and barristers. Blanket lower rates of tax – including PRSI – are therefore poorly directed at encouraging entrepreneurship or business start-ups." (Kakoulidou et al., 2021).

13.2.3. Recommendation: Class S

The Commission agrees with the proposals from the wide range of bodies that the Class S PRSI rates should increase. In this regard, the Commission recommends:

- **Increasing the self-employed PRSI contribution rate. In the first instance, the Commission recommends that Class S PRSI for all self-employed income is gradually increased from 4 per cent to 10 per cent. In the medium term, the Class S PRSI rate should be set at the higher rate of Class A employer PRSI (currently 11.05 per cent).**

13.2.4. Income yield from increasing Class S

Table 13.1 below shows the annual yields from increasing the rate of Class S PRSI by 1 percentage point in 2021.

The yield has been calculated on the basis of the following assumptions:

- Economic and demographic projection assumptions taken from the EU Commission 2021 Ageing Report (European Commission, 2021b), with no adjustment for COVID-19 effects;
- Macroeconomic effects of PRSI rate changes on earnings have not been modelled in these projections;
- Figures exclude National Training Fund Levy receipts;
- State Pension age has been modelled to remain at 66.

Table 13.1: Projections for annual PRSI yield from 1 percentage point increase in Class S PRSI

Year	Yield € millions
2030	200
2040	200
2050	300
2070	400

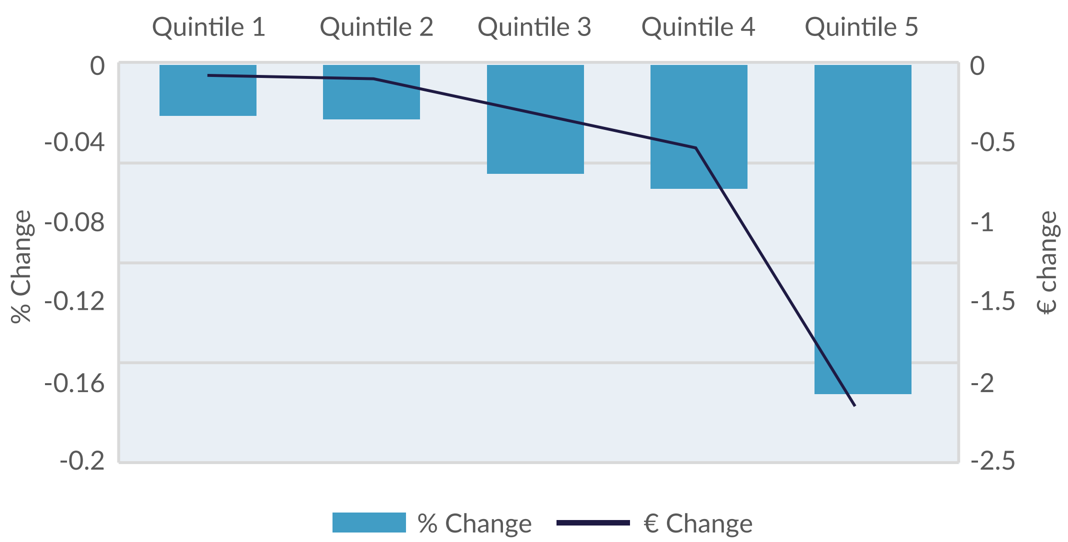
Source: DSP Investment Analysis Unit

13.2.5. Gender, Equality and Poverty Proofing: Class S

In terms of gender impacts, men are more likely to be self-employed than women (see Appendix 4A), therefore an increase in Class S PRSI rates will affect more men.

In terms of considering the poverty impacts, Figure 13.1 below displays the results of a DSP analysis using the ESRI's tax and welfare microsimulation model, SWITCH. It shows a broadly progressive distributional impact[32] by quintile of equivalised disposable income. This measure would result in very small reductions in household disposable income. There is no change to the at-risk-of-poverty rate.

Figure 13.1: Distributional impact by income quintile of increasing self-employed (Class S) PRSI by 1 percentage point (from 4% to 5%)



Source: DSP Social Inclusion Unit

The Commission considered how increasing Class S PRSI rates could have wider economic impacts, by acting as a disincentive to self-employment. The Department of Finance has found that self-assessed taxpayers are more responsive to changes in tax rates compared to PAYE workers. However, the Department of Finance noted that, "...the relatively low responsiveness compared to other countries, coupled with the well-known progressivity of the Irish income tax system, suggest that the trade-off involved in pursuing both equity and efficiency objectives in the Irish system is reasonably limited." (Department of Finance, 2018).

In this regard, the Commission proposes a gradual increase in the Class S PRSI rate (of a percentage point per year initially until it reaches 10 per cent). This would lessen the impact for the self-employed and for the wider economy compared to a sudden 6 percentage point increase.

13.2.6. Alternatives considered: Class S

The Commission considered a number of other Class S policy reforms:

- **Increasing the level of self-employed PRSI to that of an employee and employer combined (from 4 per cent to 15.05 per cent)**: The Commission examined whether increasing Class S PRSI to the combined total of the prevailing rates of employer and employee Class A PRSI could be considered once its recommendations above had been implemented. The rationale for this option would be that the self-employed should pay the same amount as paid by employees and employers to receive the same benefits.

[32] In these analyses, "progressive" reductions in household disposable income are ones that have a proportionately smaller impact on lower-income quintiles than they do on middle and higher-income quintiles.

The ESRI estimates that the impact of this measure would be broadly progressive with income losses for those in the highest income decile just over twice the figure for households on average, while losses for those in the lower half of the distribution would be less than half the average (Kakoulidou et al., 2021).

In favour of this, the Commission noted that the self-employed social insurance rate in a number of European countries, (Croatia, Hungary, and Slovenia) is the same as the combined total of employer and employee rates (Deloitte, 2017).

However, given that its work did not include an examination of all the facets of social insurance, the Commission considered that increasing the Class S rate to the higher rate of the employer Class A rate is a sufficient policy goal for the medium term. The Commission on Taxation and Welfare may wish to consider this further in line with its terms of reference relating to the structure and coverage of social insurance (Commission on Taxation and Welfare, 2021).

- **Increasing the minimum Class S payment from €500 to €1,500:** As noted earlier, currently a self-employed person earning €5,000 per year pays a minimum payment of €500 for a year's social insurance contributions. The rationale for this option is that at present, the value for money for a person paying the minimum Class S payment is very high, in terms of the return received from the social insurance system relative to the amount paid in. A DEASP paper for the Tax Strategy Group estimated that introducing this measure would result in a yield of €146 million per annum (DEASP, 2019). This would result in a person earning €5,000 in self employment paying the equivalent of a 30 per cent PRSI contribution rate. Analysis by the Department using the ESRI's SWITCH model found that this measure had a regressive impact, with the strongest effects on those in the lowest income deciles. On the basis of the regressive impact of this proposal the Commission decided not to proceed with this option.