

**Department of Social and Family Affairs**

**PRSI issues 2007**

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## 1. Introduction

This paper outlines some key policy issues relating to any consideration of PRSI changes for 2007. The paper is divided into a number of sections. **Section 2** summarises significant PRSI developments which took place during 2006. **Section 3** sets out the current financial position of the Social Insurance Fund as well as the future outlook, while **section 4** outlines some of the demands on the social insurance system which could have an influence on budgetary policy. **Section 5** examines some options for reform of social insurance.

## 2. Developments in 2006

A number of measures have been progressed this year in relation to the Social Insurance Fund. The first related to budgetary changes announced in December last, while provision was made in social welfare legislation earlier this year to improve insurance coverage for childminders.

### 2.1 Budget 2006 – PRSI rates

The PRSI and Levies changes announced in Budget 2006 were:

- An increase of €2,420 in the Employees' Annual Earnings Ceiling from €44,180 to €46,600 with effect from 1<sup>st</sup> January, 2006.
- The PRSI threshold for employees in Classes A and H is increased from €287 p.w. to €300 p.w.
- The threshold at which the Health Contribution starts to be paid is increased from €400 to €440 p.w. The annual ceiling for payment of the Health Contribution has increased to €22,880.

#### Employee PRSI

Item	Change 2006	Cost/Yield to Social Insurance Fund
Employee PRSI Annual Earnings Ceiling	€2,420 increase from €44,180 to €46,600 p.a.	€25m Yield
Employee PRSI Threshold	PRSI threshold increased from €287 to €300 p.w.	€8.7m Cost
Employee Rate (Classes A (4%) and H (3.9%))	No change	N/A
Health Contribution Threshold and Ceiling	- Threshold Increased from €400 to €440 p.w. - Annual Ceiling increased to €22,880.	- Nil impact on SIF  -Cost to Exchequer of €31.6m in full year

The increases in the employee PRSI annual earnings ceiling reflects the normal indexation designed to maintain the real value of the ceiling. It is provided for in legislation and avoids the erosion of PRSI contributions.

#### Employer PRSI

Item	Change
- Employer Rate (High – 10.75%)	No change
- Employer Rate (Low – 8.5%)	No change

### **Self Employed PRSI**

<b>Item</b>	<b>Change</b>
Class S rate – 3%	No change
Min. Contribution – €253 p.a.	No change

#### **Levies:**

- The National Training Fund Levy, which is paid alongside PRSI, remained at 0.7%.
- The Health Contribution rate was unchanged.
- The threshold at which employees start the Health Contribution starts to be paid is increased from €400 to €440 p.w. The annual ceiling for payment of the Health Contribution has increased to €2,880.

## **2.2 Childminding Income**

The child-minding relief, announced by the Minister for Finance in Budget 2006, was provided for in the Finance Act 2006. The scheme allows an individual to supervise up to three children in his or her own home and exempts all related child-minding earnings – up to a maximum ceiling of €10,000 per annum – from taxation.

In order to ensure that all those who participate in this scheme are afforded the opportunity to build up a social insurance record that can, in turn and in time, have important advantages for benefits such as pensions and maternity benefit, legal provisions in the Social Welfare Law Reform and Pensions Act 2006 required that an annual PRSI contribution rate of €253 be made in respect of this child-minding income. This is in keeping with the Government's recognised policy of making every effort to encourage the extension of pension coverage nationwide.

## **2.3 Actuarial Review of the Social Insurance Fund, 2005**

The Social Welfare Consolidation Act requires that the Minister undertakes an actuarial review of the position of the Social Insurance Fund at five year intervals. The previous review was published in October 2002 and reflected the position of the SIF at the end of 2000. The next review is required to be published before the end of 2007 and will reflect the position of the Fund at the end of 2005.

An RFT inviting interested parties to undertake the review on a consultancy basis was published in June 2006. At the closing date for receipt of tenders (August 2006), four tenders were received. Following an evaluation process Mercer Human Resources were selected as the preferred bidder. While contractual arrangements are now being finalised, it is expected that the report will be published during the summer of 2007, well ahead of the deadline of the 31<sup>st</sup> December 2007.

The focus of the Review is the income of the Fund (including the accumulated surplus), the contributory pensions and benefits paid from the Fund, including non-cash benefits (Household Benefits Package) and other payments (Redundancy and Insolvency Payments). The period covered by the Review will be 55 years (from 2006 to 2061).

The results will inform both short to medium term and long term policy development in relation to the social insurance system generally and allow for the SIF surpluses built up in recent years

to be considered in its proper context. It is envisaged that the core of the review will update the 2000 review, particularly in relation to the impact of recent policy and demographic changes.

The contract also provides for a number of examinations in addition to the core review. These include:

- to project the long-term cost implication of a number of policy proposals should they be advanced, including for example invalidity pensions for the self-employed, paid parental leave;
- to consider for the first time the impacts of public insurance coverage in redistributing contributions among specific cohorts of workers and their role in supporting income solidarity among workers;
- to project of the effect of current and future migration,
- to consider some of financial issues related to the SIF related including distinguishing the proportion of contributions paid towards long-term pensions and short-term benefits entitlements from both a cashflow and cyclical funding perspective and
- to examine the ongoing liquidity of the Fund and the potential for a proportion of contributions which could be invested on a longer term.

### 3. Financial position of the Social Insurance Fund

#### 3.1 Overview of current position

The financial position of the Social Insurance Fund has improved substantially over the last number of years.

- The Social Insurance Fund moved from a deficit of €127m in 1996 to an expected surplus of €30m in December 2006 (subject to review);
- The current estimate for the accumulated surplus to the end 2006 is €3 billion.

#### *Financing the Social Insurance Fund, 2004, and 2005*

Income Source	2004		2005	
	€000	%	€000	%
Employer Contributions	4,000,313	70.8	4,365,779	70.9
Employee Contributions	1,257,639	22.3	1,362,423	22.1
Self-employed Contributions	356,620	6.3	481,452	6.2
Investments	34,594	0.6	49,012	0.8
Other Receipts	454	0.0	126	0.0
Total Income	5,649,620	100.0	6,158,792	100.0
SIF scheme Expenditure	5,272,543		5,663,427	
Surplus	377,077		495,365	
Accumulated surplus	1,906,000		2,401,000	
Annual Surplus expressed as no. of monthly SIF costs	0.86 months (26 days)		1.04 months (31 days)	
Accumulated surplus expressed as number of monthly SIF costs	5.27 months (5 months, 8days)		5.08 months (5 months, 2 days)	

Note: the breakdown between employer and employee contributions requires a detailed analysis of data collected by the Revenue Commissioners. The contributions are apportioned on the basis of the most recently available information and are of necessity provisional

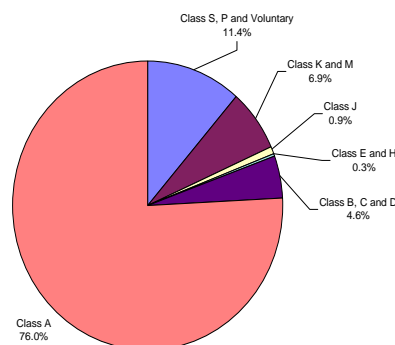
The level of total social welfare expenditure (€12,168m) financed from the fund remained stable from 2004 to 2005, falling by just 0.2% in the period to 46.5%. This compares with

social insurance funded expenditure of 41.5% (equivalent to €2,215.2m) of total social welfare spending in 1995.

The level of spending on social insurance benefits has increased significantly, particularly in the old age, retirement and widow's social insurance schemes. This reflects increased numbers of insured workers and consequent accrued protection and changing demographics.

**PRSI Class A** covers those employees in industrial/commercial type employment with earnings of more than €38pw for all benefits.  
**PRSI Class S** covers the self-employed for pensions and maternity /adoptive benefit.  
**Class K** denotes those who pay the health contribution only. **Class M** is for those with an income but with no liability for SI or the health con.  
**Class J** covers those earning less than €38 pw or in subsidiary employment for OIB only.  
**Class E** covers Church of Ireland members for all benefits and pensions, apart from UB. **Class H** covers the Defence Forces for all benefits and pensions.  
**Classes B, C, and D** cover civil servants, Army Nursing Service and public servants respectively for limited benefits, where they were employed before 1995

Graph 8 Analysis of Insured Population, 2004



Income to the Social Insurance Fund is determined by a combination of:

- numbers in employment and self-employment with PRSI liability,
- average level of earnings
- distribution of earnings and their interaction with various thresholds and ceilings within the system,
- PRSI contribution rates.

The ESRI Quarterly Economic Commentary (Summer 2006)<sup>1</sup> forecasts continued employment growth (74,000) for 2007, with strong immigrations flows of 62,000. They project an unchanged unemployment rate of 4.4 per cent and wage growth of 5.5 per cent. While the Department of Finance would generally be somewhat more conservative in its projections, it can be assumed that overall the indicators bode well for the immediate sustainability of the Social Insurance Fund, provided spending is restrained and PRSI contribution rates remain stable in the short term.

### 3.2 Longer-term financial outlook of SIF

The first review of the financial position of the SIF, as required by legislation, was completed in 2002 by external consultants. The aim of the review was to establish the medium and longer-term financial position of the SIF and in particular to consider the adequacy of rates of contribution to the SIF, both now and in the future. The findings of that review have been set

<sup>1</sup> Used in the absence of the as yet unpublished Department of Finance Economic Review and Outlook 2006.

out in previously PRSI papers to the TSG. Given the changes since 2000, especially in relation to demographics, migration, labour force participation and earnings, the conclusions could no longer be considered to be reliable. The second actuarial review of the fund, as outlined in section 2 above, should provide a more immediately relevant long-term view of the sustainability of the fund.

## **4. Commitments and Pressures on Social Insurance Fund**

The short to medium term demands on the SIF include a number of significant Government commitments which could potentially have significant implications for expenditure in the short and longer term.

### **4.1 Payment rates**

Commitments in relation to social welfare payments rates have already been set out today in TSG paper (06/09). The main ones with implications for the social insurance system in the context of Budget 2007 are the commitments to increases in social welfare pensions to a target of €200 per week, increasing the lowest rates to €150 per week in 2002 terms, improvement in widows/ers pensions and maternity benefit as well as increasing the qualified adult allowance rates.

### **4.2 Towards 2016**

The partnership agreement reached earlier this year (Towards 2016) promotes a fresh approach to enhancing employability, through achieving a balance between flexibility and security.

While T16 is not specific in terms of SIF-funded measures, commitments are made which may place additional pressures on the Social Insurance Fund in the near future including;

- to examine the social protection to support atypical working, the reconciliation of work and family life and those on low incomes;
- to achieve the NAPS target of €150 per week in 2002 terms for the lowest social welfare rates by 2007 and
- continuing the review the scope of carers benefit in the light of a range of existing recommendations.

The social insurance system has been progressively improved to assist atypical workers and those with caring or family responsibilities including measures to maintain a contribution records through the award of credits, the easing of contribution conditions to establish entitlement for work-sharers, extending the duration of maternity benefit and measures to support carers.(See appendix 1 for a list of SIF funded improvements since 1988). The commitments in T16 will add to these measures already in place.

## **5. Proposals for Improvements to Social Insurance System**

### **5.1 Remove anomalies**

Some anomalous situations have been identified in the different treatment of income for tax and social insurance purposes. For the most part, these differences are consistent with maximising

social insurance coverage. However, some are inconsistent with the principles of good regulation where they are not based on a strong rationale supporting the variance in treatment of income. The following two items i.e. the treatment of pension contributions paid by the self-employed over those who are employed or are proprietary directors and the assessment of greyhound service fees are discussed below.

### **5.1.1 Pension Contributions for the Self-Employed**

In relation to self-employed contributors who are outside the PAYE system, there is no provision for the payments made towards future private pension provision to be exempted from liability for PRSI contributions. However, self-employed contributors on the PAYE system i.e. proprietary directors and employees may avail of PRSI relief on these payments. The legislation which provides that these refunds are effective for any contribution year commencing after 1 January, 2003 and specifies that PRSI paid on the portion of the pension contribution which is allowable as a deduction for income tax purposes may be returned. For self-employed workers the refund is available only to those who are in receipt of reckonable emoluments and are liable to income tax on the PAYE (Schedule E) system. The relief is available by way of a refund from the Office of the Collector-General.

This issue was the subject of a number of representations to both this Department and the Department of Finance over the past year. Data from the Revenue Commissioners for 2002 (latest available) indicate that some 60,000 self-employed contributors are claiming income tax relief on contributions to retirement annuity contracts at a tax cost of €90.7m. The loss to the fund if all the pension contributions would be allowable would be very large. In 2003, the PRSA scheme was introduced. By June this year there were some 78,000 PRSA accounts with over 31,000 of these arranged through employers. Assuming that, at a maximum, all of the balance are self-employed contributors on self-assessment, for the purposes of costing, it is assumed that some 120,000 self-employed workers could avail of any proposed measure for the relief of PRSI from private pension contributions.

However, similar to the tax treatment of pension contributions for employees, it would be proposed that a threshold would be applied to the relief. To align the ceiling to the tax relief ceiling would be financially unsupportable for the Fund. As shown in Appendix 2, a ceiling of €2,500 per annum to benefit from PRSI relief would mean a maximum loss to the SIF of €9m or 0.16% of the 2005 surplus. A ceiling of €7,500 per annum would cost €27m or 0.48% of the surplus, but relief at this level is not recommended.

In the interests of ensuring this proposed exemption would not be used as a mechanism to fully avoid liability for social insurance, the legislation could be framed to ensure that no regard would be had to this exemption for the purposes of deriving reckonable income for PRSI purposes. This would mean that the minimum PRSI contribution of €53 per annum would be payable where income is over €3,174pa. The impact of this would be that the exemption would progressively only benefit those with income in excess of €3,500pa up to the income level at which the ceiling on PRSI relief would be applied.

This proposal would be go some way to removing the current inequity in the treatment of private pension contributions for different workers and is in the interest of supporting government policy towards investment in personal pension coverage. The arguments that have previously been made against the exemption of these private contributions from liability relate to the cost of such a measure, the fact that at the same time the cost of benefits and pensions for which the self-employed are eligible is unaltered and that self-employed workers already enjoy

a reduced rate of contribution at 3% of reckonable income. Accordingly, the appropriate counterbalancing proposed would be to consider a cost-neutral increase in the rate of PRSI Class S contribution. However, it may be more useful to discuss this in the context of the results of the Actuarial Review of the Fund next year.

In the meantime, a modest ceiling of €2,500 - €3,500 which would benefit from PRSI relief could be supported by the Fund.

### **5.1.2 PRSI on Greyhound Fees**

Section 233 of the Taxes Consolidation Act, 1997 provides that certain profits/gains arising to an owner or part owner of a stud greyhound from the sale of services of greyhound bitches within the State by the stud greyhound or from the sale of rights to such services (that is, stud fees or receipts from the sale of nominations) are exempt from income tax or corporation tax. This provision was effective from 6<sup>th</sup> April 1996. The treatment of this income is similar to exemptions provided under s.231 (profits or gains from stallion fees) and s.232 (profits from occupation of certain woodlands). Income from greyhounds is not liable for PRSI contributions under the definition of reckonable income for PRSI purposes and the tax exemption will, in any event, end on 31st July, 2008.

On the introduction of the scheme in 1996, the Minister for Finance stated that the scheme was to be framed on same basis as the existing exemption from tax of stallion stud fees. There is no evidence of any deliberate policy to exclude this income from PRSI liability. Information from the Revenue Commissioners indicates that nine people availed of the tax exemption with total income of some €394,000 in 2004. While the yield to the Social Insurance Fund would be small, bringing this income into insurance liability would support the contributory principle and potentially enhance future pension entitlement of the individuals concerned. Such a measure would align the treatment of greyhound stud fees with similar provisions for stallion income and address the existing anomalous situation. The change, which could be effected from 2007, would require amendments to primary legislation but this would not be complicated.

## **5.2 Indexation of employee PRSI ceiling**

Previous PRSI papers to the TSG discussed the abolition of the PRSI ceiling for employees (TSF 04/13, TSG 03/17). These proposals have not been progressed thus far. As a measure towards progressively moving towards an abolition of the ceiling and ending the PRSI holiday, it is proposed to establish a more realistic basis for up-rating the PRSI ceiling.

### **Current practice**

Social welfare legislation provides for the indexation of the employee PRSI ceiling (SW(C)A, 2005): *“the Minister shall take into account any changes in the average earnings of workers in the transportable goods industries so recorded by the CSO since the date by reference to which the sum specified ... was last determined”*.

Current practice for up-rating the ceiling is that in August/September, macroeconomic projections for earnings growth in the following year are received from the Department of Finance and these are then used to estimate a new ceiling for the following year. On this basis a new ceiling is proposed then used as the basis of calculations underpinning the abridged estimates volume. For 2007, it is proposed that the new ceiling will be €48,880pa<sup>2</sup>.

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<sup>2</sup> Based on a 4.8% projected increase in wages (private) for 2007 (Dept. of Finance)

The final decision in relation to the ceiling is announced in the Budget with changes to primary legislation shortly afterwards to allow the new ceiling to take effect for the beginning of the New Year.

### **Issues with transportable goods index**

While the general approach still remains valid, the legislative provision is relatively old. The labour market has changed over the years and it may now be appropriate to give some consideration to the manner in which the ceiling is calculated. In particular the changes include the following:-

- a. the transportable goods indicator has been largely superseded in public consciousness by the manufacturing (transportable goods less mining, quarrying and turf) and industry (transportable goods plus utilities but not including construction<sup>3</sup>);
- b. the relative size of the transportable goods sector has fallen relative to total private sector employment because of the very rapid the rise in services and the construction sector and
- c. since 1995, when PRSI was extended to include new public servants, public servants are increasingly included as Class A contributors.

Assuming the objective is to maintain the level of the ceiling relative to earnings of those in insurable employment, a relatively broadly based indicator (including public servants) may possibly be more appropriate. Current practice is to use projected private sector wage increases for the coming year - it may be better to use a combined indicator (perhaps relating to the concept of wages and salaries from the national accounts). Broadening the base may lead to greater deviations between forecasts and actual outturn - this is something which might be considered by Department of Finance.

The second issue relates to whether a leading or lagging indicator of wage development should be used. That is, should we actually rely on actual published estimates of wage changes or on forecasts? Currently, the practice is to rely on forecasts which take project changes in the following year. A strict interpretation of the legislation may imply that the only information which could be used is that published at the time that the ceiling is up-rated. However, this would not lead to a reasonable interpretation of the legislation, as effectively only wage changes in the first half of the year would be taken into account and the ceiling would fall every year relatively to earnings. One way of handling it would be to increase every year using the projection of earnings provided by the Department of Finance and every five years or so – possibly linked with to the timing of the actuarial review - to have a formal reconciliation between the published indicators and the movement in the ceiling.

Either way there would appear to be an argument for changing the legislation to take account of current practice. The main argument against it relates to the fact that we may be asked or expected to replicate this indexation for all other items within the PRSI system (threshold etc) and even in the payments system (disregards etc).

It is proposed that some work be undertaken to examine these issues so as to derive a more appropriate index, or combination of indices, by which to reference any increase in the PRSI ceiling.

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<sup>3</sup> The construction sector is included in the national accounts definition of industry but not in the industrial production, employment or earnings indicators

6. The TSG is invited to consider these issues.

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PRSI Planning  
Dept of Social & Family Affair

## ***Appendix 1: Improvements in social protection 1988 – 2006*** **(Excluding improvements in payment rates)**

- 1988** - Social Insurance for the Self Employed introduced;
- 1991** - Part- time Workers (earning in excess of £25 per week, now €38) covered by full rate Social Insurance;
- 1994** - Widower's Contributory Pension introduced;
  - Homemakers disregards introduced;
- 1995** - Community Employment workers covered by full rate Social Insurance;
  - All new civil and public servants covered by full rate Social Insurance;
- 1997** - Maternity Benefit extended to self-employed contributors;
- 1998** - Introduction of credits for Parental Leave;
- 2000** - Carer's Benefit introduced;
- 2001** - Changes to contribution conditions for short-term benefits to facilitate worksharers;
  - Extension of duration of maternity benefit;
  - Award of credited contributions for unpaid statutory maternity and adoptive leave
  - Free Scheme extend to all aged 70 years and over regardless of income and household composition
- 2002:** - First Actuarial Review of Social Insurance Fund published.
  - Introduction of household benefits package
  - Improvements in linked DB claims
- 2003** - Telephone Allowance to be extended to people on social insurance payment (and others) aged 70 or over, residing in nursing homes where they have their own telephone account.
  - Free Schemes to be extended to pensioners on social insurance schemes (and others) under age 70
  - Improvements in PRSI scheme for Share Fishermen (Optional Class P)
- 2004** - Increased duration for adoptive benefit from 14 to 16 weeks
- 2005** - Easing of conditions for receipt of Carer's benefit (access and earnings limitation)
  - Easing of conditions for entitlement to full-rate Disability Benefit for those transferring from Long-Term UA or OIB
  - Increase in rate of Maternity Benefit from 70% to 75% of reckonable weekly earnings.
  - Increase the income threshold for entitlement to half-rate Child Dependant Allowance for those on UB, Injury Benefit and Health & Safety Benefit.
- 2006:** - Introduction of fixed rate PRSI contribution for self-employed home-based childminders

- Increase in rate of Maternity Benefit from 75% to 80% of reckonable earnings
- Duration of Maternity Benefit increased from 18 to 22 weeks + additional 4 weeks unpaid statutory leave attracting credited contributions
- Grant automatic entitlement to Old Age Contributory Pension at age 66 to Invalidity Pension recipients.
- Extend duration of Carer's Benefit by 9 months to 24 months.
- Introduce alternative contribution condition for entitlement to Treatment Benefit (26 paid contributions in Relevant Tax Year and previous Relevant Tax Year).

## Appendix 2: Cost of PRSI Relief for Personal Pension Contributions on SIF

Maximum Income to benefit from PRSI Pension Relief and effect on SIF at different levels of relief.

Pension Relief	Max relief	Max. Income < or = €pa	Existing PRSI liability	PRSI liability after pension relief	Cost to SIF €m	Expressed as % of 2005 surplus	Comments
		3,174	253	253			Min. income threshold
		8500	253	253			Income where min. con.= 3%
2,500	75	10,945	328	253	9.00	0.16	
3000	90	11,420	343	253	10.80	0.19	
3500	105	11945	358	253	12.60	0.22	
4000	120	12420	373	253	14.40	0.25	
4500	135	12933	388	253	16.20	0.29	
5000	150	13433	403	253	18.00	0.32	
5,500	165	13980	419	253	19.80	0.35	
6000	180	14433	433	253	21.60	0.38	
6500	195	14900	447	253	23.40	0.41	
7000	210	15400	462	253	25.20	0.44	
7500	225	15920	478	253	27.00	0.48	