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Department of
Social Protection

Pay Related Social Insurance

Budget 2018 Issues

Tax Strategy Group 17/04

An Roinn Coimirce Sóisialaí
Department of Social Protection

TSG 17/04

Pay Related Social Insurance – Budget 2018 Issues

The Social Insurance System

1. The Social Insurance system is central to the provision of social security in Ireland. It plays a major role in Irish life both in terms of the number of people who depend on it and also the financial and economic scale of the system.

2. The basic principle underlying the social insurance system is that people, while they are economically active, make social insurance contributions in accordance with their ability to pay at various rates depending on the range of pensions and benefits for which they will qualify. It is an important vehicle of income redistribution, social cohesion and solidarity between generations including those in work and those who are not. Contributions finance pension payments to an earlier generation of contributors and also pay for benefits to people who are temporarily economically inactive through illness or short term unemployment. In return, employees and self-employed build up entitlements on foot of their contributions, which will be paid to them as of right, without having to undergo a means test, when they themselves need them, for example when they are no longer economically active.

3. This paper reviews the financial position of the Social Insurance Fund (SIF), the main PRSI related measures introduced in the last Budget and the PRSI income and expenditure commitments in the new Programme for a Partnership Government. In particular, the paper discusses the possible restructuring of the system of personal taxation as a means of supporting the future financial security of the SIF, and the extension of additional social insurance benefits/pensions to the self-employed.

   Finally, the paper looks at the threshold at which employees become insurable for social insurance purposes.

Social Insurance Fund – Financial Position

4. The SIF operates on a pay-as-you-go basis, with the Exchequer acting as the residual financier of the Fund, where there is a shortfall between Social Insurance income received and the cost of social insurance benefits paid.

5. The SIF was established in the early 1950s and annual Exchequer contributions were the norm for over 40 years.[1] However, no Exchequer contribution was required over the period 1997 to 2007 inclusive, as social insurance income exceeded Fund expenditure. At the end of 2007, an accumulated surplus of €3.6 billion had been built up.

6. In 2008, the current operating balance of the SIF moved into deficit and the deficit accelerated rapidly in 2009 (€2.5 billion) and 2010 (€2.75 billion) as the recession took hold. This meant that the accumulated surplus built up over 11 years was exhausted in

[1] For example, in 1967, the State contribution was 38% of SIF expenditure and almost 29% in 1985.

less than 3 years (driven by very large increases in expenditure on Jobseeker's Benefit and the ongoing rise in the number of pensioners).

7. The annual deficit has declined significantly since 2103 with a surplus of €453 million recorded in 2016. The Revised Estimates for 2017 provides for a surplus of €611 million.

Table 1: SIF income and expenditure, 2011 to 2017.

	2011 outturn	**2012 outturn**	**2013 outturn**	**2014 outturn**	**2015 outturn**	**2016 outturn (provi-sional)**	**2017 REV estimate**
	€ Millions	*€ Millions*	*€ Millions*	*€ Millions*	*€ Millions*	*€ Millions*	*€millions*
SIF income	7,544	6,781	7,318	7,891	8,498	9217	9,599
SIF expenditure	9,004	8,870	8,632	8,431	8,617	8,764	8,988
Surplus/ deficit	**-1,460**	**-2,088**	**-1,314**	**-540**	**-119**	**453**	**611**

8. A large number of structural PRSI income measures were introduced over the period since 2009 which have had a positive impact on the funding of the SIF. These measures included increases in rates of some contributions, the abolition of the employee ceiling for charging PRSI, the abolition of relief from PRSI previously applied to employee pension contributions, the abolition of the employee PRSI-free allowance as well as the broadening of the base on which PRSI is charged through the abolition of exemptions.

9. Over the same period, these revenue raising measures were accompanied by extensive expenditure reducing measures including stricter contribution conditions for entitlement and reductions in duration of entitlement, most notably for Jobseeker's Benefit and Illness Benefit, removal of entitlement to concurrent social insurance payments, increases in pension age to 66 years[2], changes in the level of entitlement to the State Pension (Contributory) where people do not have a full contribution history, standardisation of the rates of Adoptive and Maternity Benefit and reductions in entitlements under the Treatment Benefits and Redundancy payments schemes. In addition, the rates of weekly payments paid to persons aged under 66 years, such as Jobseeker's Benefit, were reduced in 2010 and 2011 by circa 7.9% in total.

[2] State pension age will further increase to 67 years from 2021 and to 68 years from 2028.

Social Insurance Contribution Rates and Benefits

10. A combined PRSI rate of 14.75% is paid in respect of most (PRSI Class A) employees (this includes a 0.7% contribution to the National Training Fund[3]). The employee PRSI charge comprises 4% payable by employees and 10.75% by their employer (there is an 8.5% employer PRSI rate where weekly earnings are under €376[4]). Employees who pay PRSI at Class A are covered for all benefits and pensions.

11. Self-employed persons who earn €5,000 or more in a contribution year are liable for PRSI at the Class S rate of 4%, subject to a minimum payment of €500. PRSI Class S contributors are covered for the State Pension (Contributory), Widow's, Widower's or Surviving Civil Partner's Pension (Contributory), Guardian's Payment (Contributory), Maternity & Adoptive Benefits, Paternity Benefit (from September 2016), Treatment Benefits (from March 2017) and Invalidity Pension (from December 2017).

12. Class S contributors are not covered for Jobseeker's Benefit, Illness Benefit, Carer's Benefit and Occupational Injuries Benefits. Self-employed workers may, however, access social welfare supports by establishing eligibility to assistance-based payments such as Jobseeker's Allowance.

Budget 2017 –PRSI Measures

13. Following Budget 2017, Class S self-employed contributors have access, for the first time, to the Treatment Benefit scheme which includes free eye and dental exams, and contributions towards the cost of hearings aids. This measure will cost €3.5m in 2017 and €4.5m in a full year. Treatment Benefit entitlements will also be extended from October 2017 so as to provide further dental and optical benefits for both the self-employed and employees. The cost of this measure is €9m in 2017 and €47m in a full year. Over 2.5m workers, including those who are self-employed, will benefit from these additional benefits.

14. Self-employed Class S workers will be also be eligible for the Invalidity Pension from December 2017. This is a major reform as self-employed people will now have access to the safety-net of State income supports, without having to go through a means test, if they become permanently incapable of work as a result of an illness or disability. The estimated 2018 and 2019 costs are €23m and €38m, respectively, and will rise further in later years.

[3] The National Training Fund is administered by the Department of Education and Skills.

[4] In Budget 2016 the threshold at which the higher 10.75% rate of employer PRSI applies was increased from €356 to the current €376 threshold. The increased threshold ensures that the employer contribution, whose employees benefitted from the 2016 increase in the minimum wage, remained at the lower employer rate of 8.5%.

Actuarial Review of the Social Insurance Fund

15. The Minister for Social Protection is legally required to undertake an Actuarial Review of the Social Insurance Fund every 5 years. The fourth Actuarial Review is currently being undertaken by external consultants (KPMG) and is well advanced. The Review will:

    i) project the income and expenditure of the Fund over a 55 year period, taking into account policy, economic and demographic changes since the previous review was undertaken;

    ii) project the costs of various options for the indexation of benefits such as indexation to earnings or prices;

    iii) examine breakeven rates of contributions to fund payments in the years ahead;

    iv). determine the value for money delivered by social insurance for employed and self-employed contributors;

    v). examine options relating to state pensions – principally the move proposed for 2020[5] to a Total Contribution Approach to determine the level of entitlement to the State Pension (Contributory), and

    vi). examine the projected PRSI contribution rates required to provide individual benefits to Class S (self-employed) contributors on a revenue neutral basis.

    The Review is expected to be completed at the beginning of Q3, with a view to publishing it in that quarter. While the economy has improved well ahead of the projections available at the time of the last review (completed in the first half of 2012), it is anticipated that financing the SIF will continue to remain a major challenge in the years ahead.

16. In this regard, it should be noted that weekly contributory pension payments will account for slightly over 70% of total SIF expenditure in 2016. Accordingly, increases in the level of pension payments generally allied with increasing numbers of pensioners as mentioned above will have a significant impact on the SIF over the coming years

Looking Ahead

17. The core issue of how to deal with future shortfalls in the Social Insurance Fund, without unduly penalising any particular sectors of society, involves a balance between:

    i) Scheme-related expenditure measures (relating to rates of payment, duration of payment and measures relating to eligibility),

    ii) increases in PRSI contribution rates, and

[5] In the National Pensions Framework, 2010.

iii). structural changes in the level of cover provided for contributors generally or, alternatively, for specified groups of contributors and the necessity to fund same.

Programme for Government Commitments

18. The Programme for Government includes specific commitments relating to PRSI and SIF expenditure, as follows:-

- *"We will increase the State Pension and the Living Alone Allowance above the rate of inflation."*
- *"We will seek to introduce a PRSI scheme for the self-employed and provide a supportive tax regime for entrepreneurs and the self-employed".*
- *"We will reply on the annual recommendations of the Low Pay Commission on the level of adjustment each year. Working with the Oireachtas we will cut Employers' PRSI for low income workers to mitigate the cost of minimum wage increases, in order to protect jobs."*
- *"We will also extend the Dental Treatment Benefit under the Social Insurance Fund to reimburse the cost of some routine dental treatments. For medical carholders, we will introduce a preventive dental health package also."*

The Programme also contains the following commitment in relation to the self-employed.

> *"Working with the Oireachtas, we will increase the Earned Income Tax Credit from €550 to €1,650 for the self-employed, to match the PAYE credit, by 2018."*

Restructuring of Personal Taxation

19. The Programme for a Partnership Government is also committed to reducing the burden of high personal tax rates. "*To make Ireland's personal taxation system more competitive, we will ask the Oireachtas to continue to phase out the USC as part of a wider medium-term income tax reform plan………………….that keeps the tax base broad, reduces excessive tax rates for middle income earners, and limits the benefits for high earners. Reductions will be introduced on a fair basis with an emphasis on low and middle income earners."*

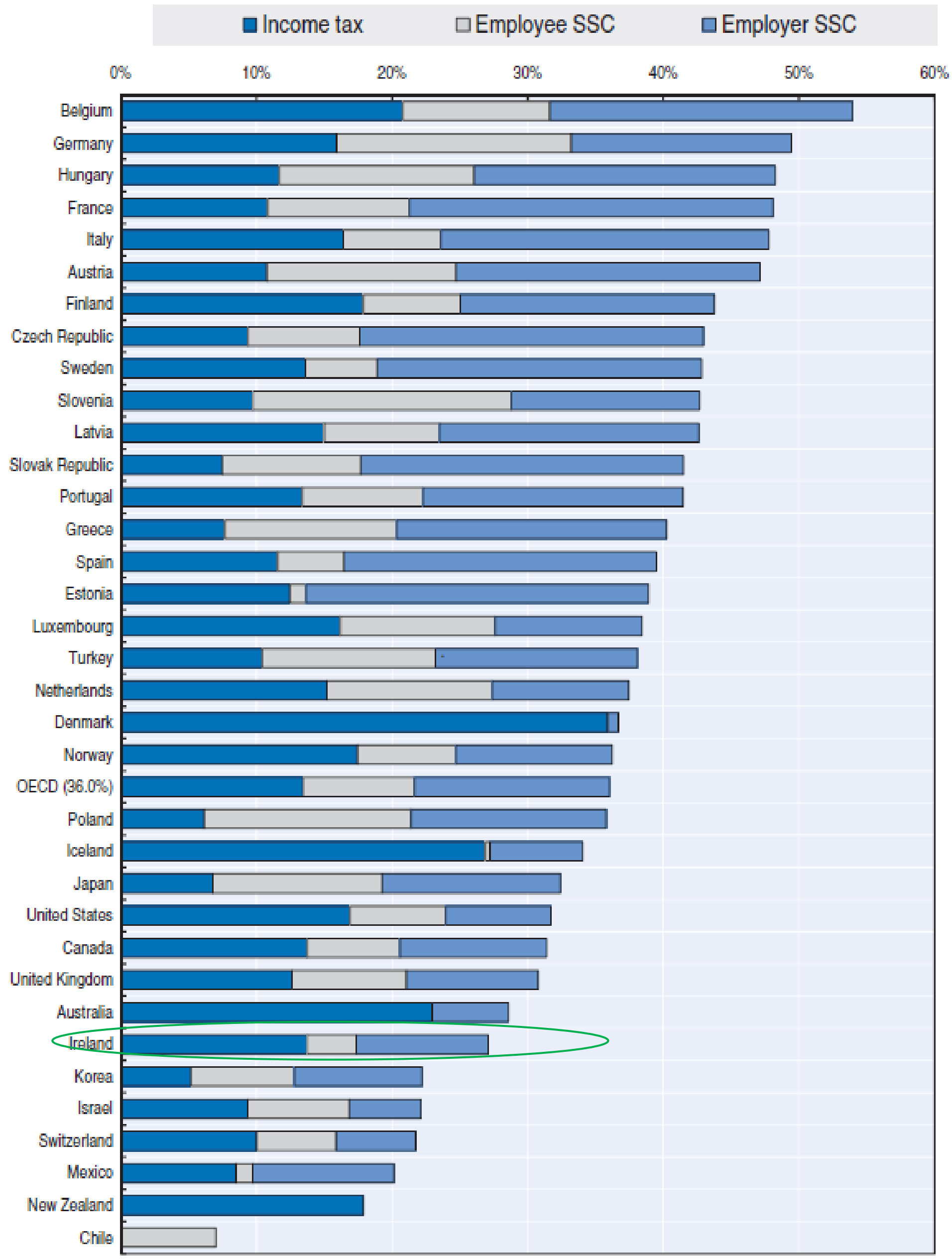
20. PRSI contributions (c €9bn in 2016) are one of three statutory deductions from earnings/income – PAYE income tax (€12bn in 2016) and the Universal Social Charge (USC) (€4bn in 2016) being the other two elements. Any consideration of changes to the rates and structure of the USC, in particular, might have regard to PRSI rates and structures generally and the necessity to put the SIF in a better position to face the financing pressures in the years ahead arising from demographic factors and improved benefits committed to in the Programme for A Partnership Government.

21. In this regard it is worthy of note that the proportion of labour costs/income paid in social insurance contributions in Ireland is amongst the lowest in the OECD (See chart

overleaf). There is therefore a case for increasing PRSI rates, if and as, USC rates are reduced.

Figure 1.1. **Income tax plus employee and employer social security contributions, 2016**

As a % of labour costs



Notes:
Single individual without children at the income level of the average worker.
Includes payroll taxes where applicable.

StatLink http://dx.doi.org/10.1787/888933460105

22. USC and PRSI are broadly charged on the same income base but some differences do exist. The yield from any increases in PRSI would, therefore, be less than the equivalent USC yield:

i. USC is charged regardless of age whereas PRSI is not charged for those over pension age;

ii. USC has a wider income base e.g. it applies to occupation pensions, and

iii. USC is charged on an annual cumulative basis, whereas PRSI is charged on a "week one" basis (i.e. the PRSI charge only applies where the weekly thresholds are exceeded without regard to cumulative annual income).

The approach could be implemented on a phased basis or at different ranges of income over a period of years.

Extending Social Insurance Entitlements for the Self-employed

23. All of the measures for the self-employed announced in Budget 2017 (already outlined above) were introduced without any increase in the 2017 rate of PRSI contribution paid by self-employed workers. The main financial impact of the improvements is in 2018 and later years.

24. The Programme for Government commits to seeking "*to introduce a PRSI scheme for the self-employed and provide a supportive tax regime for entrepreneurs and the self-employed"*. Further progressing this commitment will include consideration of a range of policy, financing, legislative, administrative and control issues, including:

    i. Other Government commitments impact on the SIF such as increasing supports for pensioners.

    ii. An actuarial assessment of the cost of any extension of cover and the appropriate additional rate of contribution for any given new benefit;

    iii. The need, if any, to tailor the conditions of a benefit to take account of the nature of self-employment and associated income deriving e.g. longer waiting periods, shorter durations of payment, seasonal self-employment etc.

    iv. Longer term issues derived for the fact that some self-employed e.g. with businesses may be in a position to continue to derive income/profit from same thereby not experiencing a significant (or any) loss on income, and

    v. Control issues arising from the fact that, unlike the employee situation, there is no third party i.e. employer verification of unemployment etc.

Advisory Group on Tax and Social Welfare

25. In September 2013, the third report of the Advisory Group on Tax and Social Welfare on Extending Social Insurance Coverage for the self-employed was published.[6] The Group:

    i). was not convinced that there was a need for the extension of social insurance in respect of Jobseeker's Benefit;

    ii). did find that extending social insurance for the self-employed was warranted in cases related to long term sickness or injuries and recommended that the rate of contribution for Class S should be increased by at least 1.5 percentage points, and

    iii). concluded that "*extension on a voluntary basis, through either an "opt in" or "opt out" basis, could lead to the selection of bad risks and would undermine the social solidarity and contributory principles that underline the social insurance system*."

Survey of the Self Employed

26. In August 2016, a survey of self-employed Class S contributors was conducted to understand how the pay-related social insurance (PRSI) system is perceived by individual self-employed workers. The people surveyed were a representative random sample of all those people who depended on Class S PRSI for their social insurance contributions in 2014. Over 20,000 surveys were issued to self-employed people in August 2016 and nearly 3,200 responses were received.

27. The main findings of the survey are:

    i. Respondents rated cover for long-term illness, short-term illness and unemployment as the most important extra benefits to them. 82% ranked long-term illness in their top three of preferred additional benefits.

    ii. The current headline rate of PRSI for self-employed people is 4%. An overwhelming majority of respondents – 88% – said they would be willing to pay a higher headline rate of PRSI in return for at least one additional social insurance benefit.

    iii. A smaller majority – 74% – would welcome an option to keep paying the current headline PRSI rate but also pay additional voluntary contributions in return for extra benefit coverage.

    iv. Respondents reported low levels of coverage from private insurance, such as income continuance cover. Just 28% are covered for long-term illness and only 2% for unemployment.

[6] http://www.welfare.ie/en/downloads/Third-Report-Extending-Social-Insurance-Coverage-for-the-Self-Employed.pdf

v. Respondents were dissatisfied with the range of social insurance benefits available to them. Over 80% of respondents rated both the range of benefits and the value for money as 'poor' or 'very poor' (the survey pre-dates the changes announced in Budget 2017).

28. Given the increased range of benefits (which combined account for over 80% of payments made) the report of the AGTSW and the findings from the survey of self-employed contributors, consideration could be given to increasing the self-employed contribution rate. On a pro-rata basis self-employed contribution rates should be c 80% of Class A rates or about 12%. As part of any increase the minimum payment of €500 p.a. to qualify for full benefits should also be increased to €750 - €1,000.

Employee Social Insurance Cover – Entry Threshold

29. Ireland provides access to valuable employee social insurance entitlements to workers with negligible attachment to the workforce. Once weekly earnings exceed €38[7], the worker has access to the full range of long and short terms social insurance benefits. Based on the national minimum hourly rate of pay for employees of €9.25, an employee earning €38 per week now only has to work just over 4 hours per week, for access to all benefits. These thresholds have not been increased since 1991. CPI has increased by c 60% in the same period.

30. This access provides employees with entitlement to benefits which may be disproportionate to their income when in employment:

    i. Over their working life employees on very low earnings levels can establish entitlement to the maximum State Pension (Contribution) rate of €238.30 per week.
    ii. The minimum weekly personal rate of short-term benefits is €86.70 (i.e. Illness Benefit) are payable on weekly earnings between €38 and €150.

31. Consideration could be given to increasing the earnings threshold to €96 per week - equivalent to about 10 hours work per week (at the current minimum hourly rate) or €5,000 per annum if working continually. At this level the earnings threshold would be aligned with the annual threshold for insurability currently applying to the self-employed of €5,000.

32. Increasing the entry threshold to €96 would represent a saving for employers who would no longer pay PRSI at 8.5% for those earning between €38 and €96. There would be an initial slight reduction in income to the SIF. This would in time be offset by savings on short-term schemes as those earning below the new threshold could not establish entitlement to these benefits.

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[7] In the UK the weekly earnings threshold at which employees enter social insurance is £113, which is equivalent to €129.27 (exchange rate on 31 May 2017).

PRSI Rate Increases

33. Provisional estimates of the yield for increases in the rates of employer and employee PRSI and in the PRSI rate paid by the self-employed, are provided at Appendix 1.

34. The TSG is invited to discuss this document

Department of Social Protection

June 2017

Appendix 1

Provisional Estimates

Yields - Increases in PRSI Rates

June 2017

The following are provisional estimates for a 0.5% increase in the rates of PRSI

Rate	Full Year Yield	Gainers/(Losers)
Employer PRSI (Class A) Increase in Lower 7.8%[8] rate to 8.3%	€18.1 million	(674,800)
Employer PRSI (Class A) Increase in Lower 10.05% rate to 10.55%	€341.6 million	(1,902,400)
Employee PRSI (Class A) Increase in 4% rate to 4.5%	€343.2 million	(1,933,800)
Self-Employed PRSI (Class S) Increase in 4% rate to 4.5%	€55 million (2018) €77.5 million (2019)	(326,200)[9]

[8] The Class A employer PRSI rates of 8.5% and 10.75% include 0.7% in respect of the National Training Fund Levy.
[9] 2015 data.