

Use of Intermediary-type Structures and Self-employment Arrangements

Department of Finance and Department of Social Protection

Consultation Paper, January 2016

1. Purpose of consultation

The purpose of this Consultation is to invite submissions from interested parties on possible measures to address the loss to the Exchequer that may arise under arrangements (i) where an individual, who would otherwise be an employee, establishes a company to provide his or her services, and (ii) where an individual, who is dependent on, and under the control of, a single employer in the same manner as an employee, is classified as a self-employed individual.

It is important to note that the arrangements which are the subject of this Consultation Paper should be distinguished from the fairly common situation in which a genuinely self-employed individual either operates as a sole trader, through a partnership or incorporates his or her business. This consultation does not affect those situations.

2. Background

There is increasing diversity in the Irish labour market away from the traditional strict separation of employment and self-employment towards a more complex range of employment relationships. Practices such as outsourcing, contracting-out and zero-hour contracts have blurred the lines between dependent employment and self-employment.

The use of intermediary-type structures is becoming more prevalent as a means of providing labour. At its simplest, an individual (“the worker”) who might otherwise be engaged as an employee by the person who uses his or her services (the “end-user”), provides the services to the end-user through an intermediary. Typically the intermediary used in such circumstances is a company (usually referred to as a “personal services company (PSC)”), with only one worker (or possibly two where a spouse is also employed by the company). The company earns all, or almost all, of its income from supplying the services of the worker to third parties or in many cases to a single third party.

A variation on the PSC arrangement involves the use of what has become known as a “managed service company (MSC)”. In essence, a promoter facilitates the setting up of such a company, which is generally structured with at least six unconnected shareholders so as to avoid close company legislation¹.

¹ Close company legislation (generally anti-avoidance legislation) recognises the close link between a company and its shareholders. It prevents the withdrawal of funds by shareholders at rates of tax lower than the marginal rate of personal tax either by way of loans or converting income into capital or by payment of expenses not otherwise taxable by the legislation. In certain circumstances, it also imposes a surcharge on undistributed income of the company.

Therefore, in summary, intermediaries generally take the form of:

- a PSC (one person company) of which the worker is a director and/or employee; or
- an MSC of which the worker is one of a number of directors and/or employees.

One of the consequences of these types of arrangements from a tax perspective is that, rather than the end-user applying the PAYE system in respect of the worker, that function becomes the responsibility of the worker, through the intermediary structure.

Aside from the intermediary-type structures referred to above, there is increasing evidence that trends towards greater flexibility and casualisation have resulted in some workers being classified as self-employed even though they might not possess the characteristics of entrepreneurship and risk-taking often perceived as features of self-employment. In such circumstances, a worker may or may not have a (formal) contract of service, is classified as self-employed but, in all other respects, may be treated in the same manner as an employee.

3. Prevalence of the use of intermediary-type structures and self-employment arrangements

The use of intermediary-type structures and self-employment arrangements to provide labour has become increasingly common across a number of sectors. Revenue investigations, including the National Contractors project (which involves the review of travel, subsistence and other expenses being paid to employee/directors of companies), suggest that intermediary-type structures are most common in the pharmachem, IT and airline industries, although they are also a feature in other sectors such as media, entertainment and construction. Revenue's increased compliance interventions in the construction industry indicate that self-employment arrangements of the type referred to above are a particular feature of that industry, although it is also becoming a feature of IT, financial, legal and professional services and the creative sectors.

Cases have come to light where it appears that end-users are insisting that if an individual wishes to be engaged by that end-user, the individual must establish a PSC, be engaged via an MSC or accept self-employment status. In recent years, a number of businesses have been established to assist individuals to set up and manage their PSCs/MSCs.

4. Social Insurance considerations

Most employers and employees (over 16 and under 66 years of age) pay social insurance (PRSI) contributions into the national Social Insurance Fund (SIF). In general, the payment of social insurance is compulsory. The establishment of a PSC/MSC or the type of self-employment arrangements referred to above can result in a significant reduction in PRSI contributions into the SIF.

Generally, the class and rate of contribution payable is determined by an individual's earnings and occupation, including whether they are regarded as employed or self-employed.

Most employees aged under 66 pay class A PRSI. This applies to people in industrial, commercial and service type employment who are employed under a contract of service with a reckonable pay of €38 or more per week from employment. It also includes civil and public servants recruited after 6 April 1995. Class A contributors may be entitled to Jobseekers Benefit, Illness Benefit, Health and Safety Benefit, Invalidity Pension, State Pension (Contributory), Treatment Benefit, Occupational Injuries Benefit and Carers Benefit.

Under class A PRSI, if an employee earns over €352 per week, the employee pays 4% PRSI on all earnings. From 1 January 2016 employees earning between €352.01 and €424 in a week and who pay class A PRSI, will be entitled to a new weekly PRSI Credit which will reduce the amount of PRSI deducted from their earnings in that week².

The employer pays 8.5% on the employee's earnings up to €356 (€376 from 1 January 2016). Where the employee's earnings exceed this amount, the employee continues to pay 4% and the employer pays 10.75% on all earnings. Employees earning less than €352 gross per week do not pay any PRSI contribution. Their employer, however, pays a contribution of 8.5% on the employee's earnings and they remain class A contributors.

Class S PRSI applies to self-employed people, and working directors who own or control 50% or more of the shares in a company in which they work, where such individuals earn €5,000 or more per annum. Such an individual's PRSI contribution is 4% of income or €500, whichever is greater. As they are self-employed there is no separate additional employer contribution.

In cases where PSC/MSC or self-employment arrangements are put in place, the individuals affected by these arrangements generally pay class S PRSI and are not, therefore, entitled to the full range of benefits available to class A contributors.

In some cases, payment by an end-user may be channelled through an agent resulting in a situation where both the employer and employee class A contributions are in reality paid by the individual from the payment made by the end-user.

² Further details of changes to PRSI rates introduced in Budget 2016 are available at www.welfare.ie/en/Pages/2016-PRSI-Changes-for-certain-employees-and-employers-.aspx#

5. Issues arising/potential loss to the Exchequer

The use of intermediary-type structures and self-employment arrangements of the type referred to above can give rise to potential losses to the Exchequer. These can arise under a number of headings:

- different outcomes in terms of employers' and employees' PRSI;
- indefinite deferral of the payment of part or all of the remuneration with a consequent deferral of payment of the associated tax/USC;
- payment of unwarranted tax-free expenses;
- different pension planning opportunities; and
- different tax planning opportunities.

A consequence of the use of intermediary-type structures and self-employment arrangements is that two individuals who perform the same services for an end-user could have different tax outcomes and different entitlements to social insurance benefits. Additionally, where a determination is made in the future by the Department of Social Protection that an individual should have been a class A contributor, it may be difficult, because of the use of an intermediary-type structure, to obtain the required employer contributions.

6. Other policy considerations

It must be recognised that the type of arrangements referred to above may not be driven solely by tax or PRSI considerations. There can be clear advantages to an end-user in ensuring that individuals are not engaged as employees. The consequences for the individual include the loss of rights to holiday pay, sick pay, maternity pay and employer pension contributions. In addition, they may lose their rights to provisions of employment protection legislation such as those relating to maternity and parental leave and unfair dismissal.

7. International context

There is no straightforward solution to this complex area of tax law. Other jurisdictions have introduced measures to address the type of issues referred to above, including the UK, Australia, New Zealand and Canada.

The use of intermediary-type structures has given rise to concern in the UK as far back as the 1980s. Legislation was first introduced in 2000 to address these concerns. The original aim was to deal with PSCs but it became apparent that MSCs were also an issue and further legislation was introduced to deal with them. More recently, legislation was introduced to deal with offshore intermediaries.

The emergence and growth of self employment arrangements can be seen as part of a trend towards increased contracting out and outsourcing and has led more workers to be treated as self-employed. This trend reflects the experience in other EU countries. The reasons for the increase in self employment arrangements are varied and include:-

- changing work patterns;
- an historical feature of a particular industry, e.g. the construction industry;
- a desire for flexibility – both from businesses (e.g. in terms of managing numbers of employees or workflow) and from individuals (as a way of working);
- for managing business risks;
- the lower tax cost of self-employment (mainly PRSI, but also expenses);
- administrative burdens of employing individuals; and
- some workers describe themselves as involuntarily involved in self employment arrangements due to a lack of other opportunities or choice.

Issues around self-employment arrangements may be more marked in countries, such as Ireland, where there is a disparity in the manner in which employees and the self-employed are treated for social insurance purposes. In countries with universal (or semi-universal) social security coverage provided to all workers, there is little difference in the treatment of different employment relationships.

8. Options for addressing tax and PRSI issues

Possible options for addressing the tax and PRSI issues arising from the use of intermediary-type structures and the self-employment arrangements referred to above are:

- i. treat the worker as a class A contributor, with the employer contribution to be paid by the end-user. This option would not impact on workplace employment law;
- ii. treat a payment made by an end-user, either to defined classes of intermediary or to defined classes of individual, to be a payment to the worker liable to tax under Schedule E. This option would not impact on workplace employment law;
- iii. where an intermediary-type structure is in place, apply a surcharge to undistributed income of the intermediary; or
- iv. where an intermediary-type structure is in place, deem any undistributed income of an intermediary company to be paid to the individual who carried out the work.

9. Submissions Invited

Interested parties are invited to make submissions in relation to the issues identified above. In particular, submissions are invited on the options at section 8 above or on other possible options for addressing the tax and PRSI issues arising from the use of intermediary-type structures and the self-employment arrangements referred to in this paper.

Submissions may be emailed to taxpolicy@finance.gov.ie When responding, please indicate if you are a business, business professional, adviser, representative body or member of the public. Submissions may be posted to “Consultation on intermediary-type structures”, Department of Finance, Upper Merrion Street, Dublin D02 R583.

These addresses will be used as a single point of contact for **both** Departments.

10. Freedom of Information

Responses to this consultation are subject to the provisions of the Freedom of Information Acts. Parties should also note that responses to the consultation may be published.

All submissions should be received, at the latest, by 5:30 p.m. on Thursday, 31st March 2016.

Any submissions received after this date will not be considered.