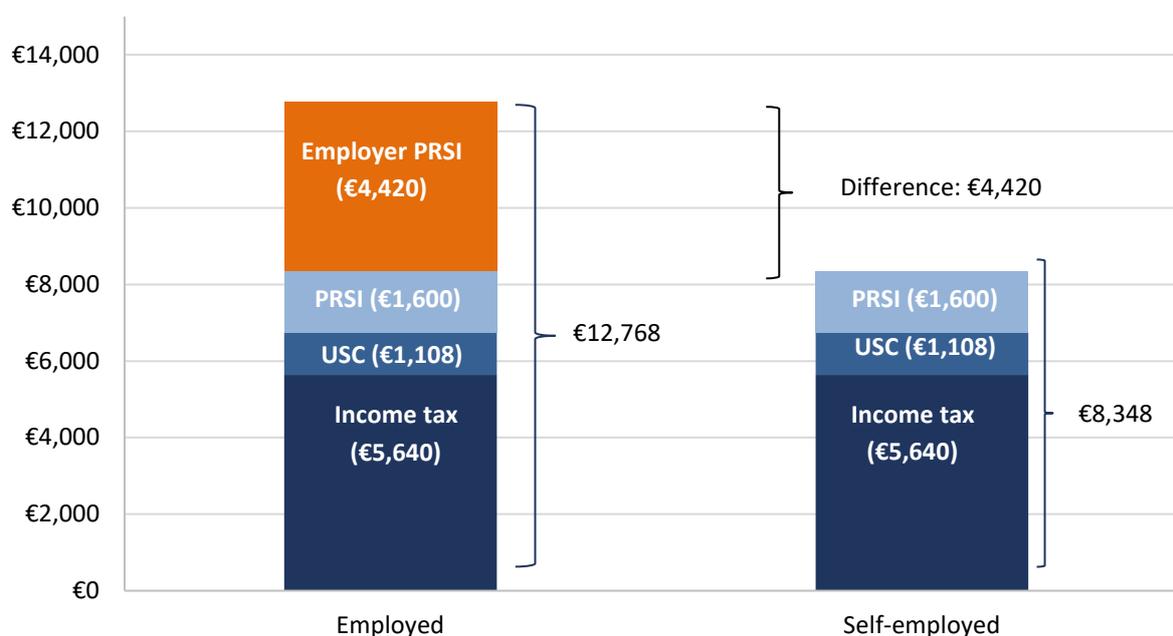


5.2 EQUALISING PRSI TREATMENT OF SELF-EMPLOYED AND EMPLOYEES

Economic activity carried out via self-employment is subject to less tax than that carried out through employment. This is because, while income tax credits and the main Class A (employee) and Class S (self-employed) rates of PRSI are the same (4 per cent), employers are required to make PRSI contributions of between 8.8 and 11.05 per cent on behalf of their employees. For example, Figure 5.2 shows that a gross employee salary of €40,000 is associated with €12,768 in tax overall: €5,640 in income tax, €1,108 in USC, and €6,020 in PRSI (€1,600 in employee PRSI and €4,420 in employer PRSI). A similar self-employment income is associated with €8,348 in tax overall: €5,640 in income tax, €1,108 in USC but only €1,600 in PRSI.

This generates a substantial gap in the total tax burden associated with each form of employment, which Roantree et al. (2018), NESI (2020) and Milanez and Bratta (2019) have argued may lead some people to operate as self-employed when they would otherwise be employed. While the lack of entitlement to certain contributory benefits has traditionally been advanced as a reason for why the self-employed pay less PRSI than employees, recent reforms have extended eligibility for the vast majority of these benefits to the self-employed. The Department of Employment Affairs and Social Protection (2020) found that these changes mean that self-employed workers now have access to around 93 per cent of the contributory benefits that employees do, in value terms, while making much fewer contributions.

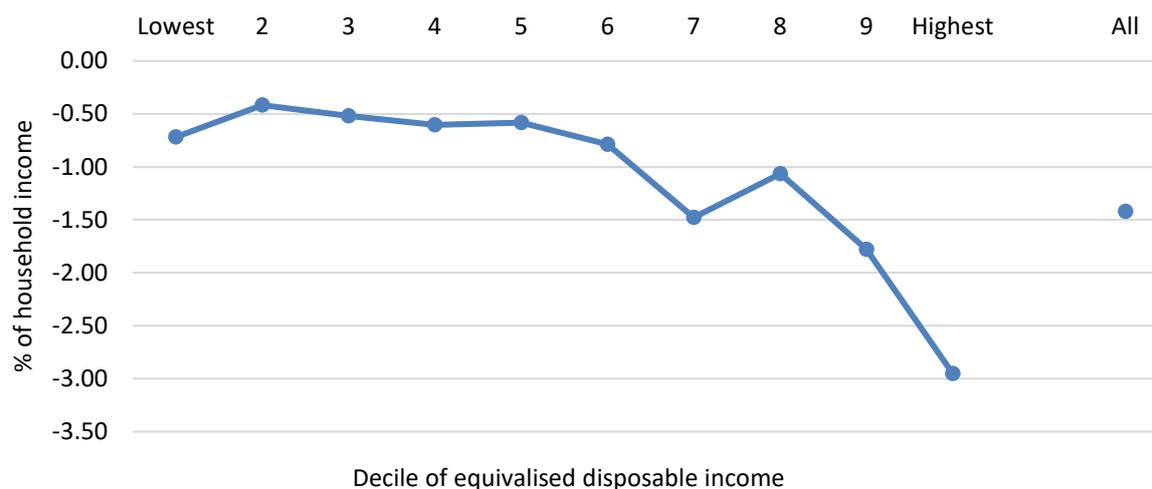
FIGURE 5.2 TOTAL INCOME TAX, USC AND PRSI ASSOCIATED WITH ANNUAL INCOME OF €40,000



Source: Authors' calculations.

Notes: Assumes single individual with no income tax deductions beyond the standard personal and PAYE/Earned Income tax credit, liable to class A employee and employer PRSI if employed, and class S PRSI if self-employed. Employer PRSI includes National Training Fund Levy of 1 per cent.

We estimate, using SWITCH, that increasing the rates of PRSI paid by the self-employed to match those made on behalf of PAYE workers would raise about €1.150 billion in revenue. Figure 5.3 shows the distributional impact of this reform, with the tax rise amounting to 1.4 per cent of disposable income on average. Losses for those in the highest-income decile would be just over twice the figure for households on average, while losses for those in the lowest-half of the distribution would be less than half the average.

FIGURE 5.3 DISTRIBUTIONAL IMPACT OF EQUALISING SELF-EMPLOYED AND EMPLOYEE'S PRSI

Source: Authors' calculations using SWITCH v3.1, run on data from the 2017 Survey of Income and Living Conditions (SILC), updated to 2020 terms using outturn and forecast wage growth from the ESRI and Central Bank of Ireland.

Note: Deciles calculated on the basis of equivalised disposable income, using CSO national equivalence scales.

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. Rather, as argued by Adam and Miller (2019), government intervention should be targeted towards areas where there is clear evidence that markets are failing to provide appropriate incentives such as research and development (where those who carry out such activities may not be able to capture the full reward from their innovation).