

Irish Tax Institute

**Response to Consultation on the use
of Intermediary-type Structures and
Self-employment Arrangements**

31 March 2016

Table of Contents

Introduction	3
Fostering a flexible labour market	5
Addressing the complexities	6
The concerns about a loss to the Exchequer	7
The issues raised in the Consultation Paper	7
<i>Issue 1 - Different outcomes in terms of employers' and employees' PRSI</i>	7
<i>Issue 2 - Indefinite deferral of remuneration with a consequent deferral of tax/USC</i>	9
<i>Issue 3 - Payment of unwarranted tax-free expenses</i>	10
<i>Issue 4 - Pension planning opportunities</i>	11
<i>Issue 5 - Tax planning opportunities</i>	11
Conclusion.....	12
Appendix I.....	13
Appendix II.....	14

About the Irish Tax Institute

The Irish Tax Institute (“the Institute”) is the leading representative and educational body for Ireland’s AITI Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax. Our members provide tax expertise to thousands of businesses and individuals in Ireland and internationally. In addition many hold senior roles within professional service firms, global companies, Government, Revenue and state bodies.

The Institute is the leading provider of tax qualifications in Ireland, educating the finest minds in tax and business for over thirty years. Our AITI Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice.

A respected body on tax policy and administration, the Institute engages at the most senior levels across Government, business and state organisations. Representing the views and expertise of its members, it plays an important role in the fiscal and tax administrative discussions and decisions in Ireland and in the EU.

Introduction

This consultation which has been published jointly by the Departments of Social Protection and Finance, considers the use of intermediary type structures and self-employment arrangements. The paper raises a number of concerns which the Departments have with certain aspects of these structures and makes four suggested options for addressing these concerns.

It is very important to understand the business context in which intermediary structures and self-employment arrangements often operate and it is with this context in mind, that the Institute has formulated its response to this submission. There are a number of factors that need to be borne in mind before implementing any changes to the framework for taxing labour including:

- The reality of the commercial environment in which these businesses operate and the imperative of having a flexible labour market to access talent in a way that fits their business model.
- The competitive pressures in the modern business environment. Businesses increasingly have global choices as to where they locate labour and investment. Therefore, changes in our tax regime which may impact on the flexibility of labour and our competitive position must be carefully evaluated.
- Whether and to what extent there is a tax leakage; and
- Whether we already have the requisite legislation, Revenue powers and administrative practices to address any perceived tax leakage.

- The new rules arising from the OECD framework will place a greater emphasis on aligning talent, people resources and substance with profit. It has never been more important for Ireland to stay competitive so as to ensure that skills continue to locate here bringing with them important business substance.

It is not clear to us that the work arrangements outlined in the Consultation Paper give rise to a loss to the Exchequer or that we need further legislative measures, such as those outlined in the Consultation Paper. The introduction of new measures without a proper Cost-Benefit analysis at the outset could negatively impact the Exchequer yield. Furthermore, it could compromise our competitive position and make Ireland less attractive as a destination for investment.

As such, we cannot recommend proceeding with any new measures in the absence of a full Cost-Benefit analysis which would take account of the full implications of any reform.

The changing world of work

The world of work has transformed completely over the past 20 years and this has had a particular impact on the high-tech, innovation and pharmaceutical sectors. New work arrangements and the way in which businesses access labour is a key component of this operational transformation. The use of contractors is now prevalent, particularly in these key sectors and three key factors have contributed to this change in work patterns:

- The increase in short-term project work (typically 6 - 18 months in duration) due to the requirement to deliver competitive advantage by bringing products and services to market much faster and more efficiently.
- The pace of innovation and the need to get to market as fast as possible demands a level of specialisation that can often only be acquired by accessing external high-calibre expertise, whether that talent is located in Ireland or overseas.
- The mobility of talent and the massive global demand for that talent means that skilled individuals have a multitude of options open to them in deciding where they would like to locate.

In light of these changing work patterns, businesses more than ever need to access flexible short term project expertise and are turning to contractors to meet that requirement.

Contractors will typically provide their services:

- As self-employed individuals; or
- through a contractor company, where the contractor is a director/employee; or
- through a specialist agency that provides the services of individual contractors.

These working arrangements are not unique to Ireland; the structural shift in labour

markets from permanent employment is a worldwide trend. This shift is undoubtedly leading to greater complexity as it impacts on employment law and the employment rights of individuals and companies as well as the tax treatment for both.

Fostering a flexible labour market

Fostering a flexible labour market is vital to support the continued growth of Ireland's economy. The Irish tax regime should continue to support both a flexible labour market and encourage genuine entrepreneurship. To do so, it is important to achieve a balance between providing certainty for both the taxpayer and the Exchequer and not creating a disproportionate compliance burden.

Ireland's labour market is considered to be one of the most adaptable and flexible in the world¹ and this flexibility is considered to be a key contributing factor to Ireland's attractiveness for foreign direct investment. This flexibility is often cited by the IDA in promoting Ireland as an attractive place to do business² and the growth of Irish software/tech sector has been attributed in part to the flexibility of Ireland's young and highly-skilled workforce³.

Economic studies show that a flexible labour force generally boosts economic growth and reduces unemployment in an economy. Ireland's economic recovery is largely dependent on the continued growth of its economy in the coming years (having been fastest growing economy in the EU in 2014 and 2015). Continuing growth in employment lies at the heart of future recovery.

In Ireland, the Central Bank has acknowledged the contribution of a flexible labour market to Ireland's strong economic recovery. The final quarterly bulletin of 2015 notes that *"the relative flexibility of Ireland's labour market.....has facilitated a more robust recovery from the trough of the recession."* This supports earlier findings of a survey conducted by the Central Bank in 2009⁴ which found that *"the level of flexibility available to firms to reduce their labour costs is an indicator of how quickly an economy can adjust to negative shocks"*.

A number of international studies similarly recognise the importance of labour market flexibility for supporting economic growth and reducing unemployment. The OECD, IMF and European Commission have all cited an inflexible labour market as the one of the most important reasons for the underperformance in European economies in previous decades.⁵ A study conducted by the IMF in 2012 recognises the relationship between labour market

¹ IMD World Competitiveness Report 2015

² IDA, "why invest in Ireland" (Summer 2015)

³ IDA Annual Report 2014

⁴ Central Bank of Ireland, "Wage Setting and Wage Flexibility in Ireland: Results from a Firm-level Survey"

⁵ Austrian Institute for Economic research, "Labour Market Reforms and Economic Growth: The European Experience in the Nineties"

flexibility and unemployment, concluding that economic policies that enhance labour market flexibility should reduce unemployment.⁶

Given that continued economic growth is vital to Ireland's economic recovery, and the policy focus on reducing unemployment, it is essential that the economic impact of any measures introduced in response to this consultation process are well thought out and do not hinder the current flexibility of the Irish labour market and by extension, Ireland's continued economic growth. The importance of maintaining a flexible work force is further emphasised in light of the UK Chancellor of the Exchequer Budget announcement on 16 March 2016, affirming the commitment to making the UK the best place in the world to locate an international business and to continue to offer a highly competitive corporate tax system.

Addressing the complexities

The Irish Tax Institute recognises the many legal and practical complexities of the new working arrangements. Other contributors to this consultation process will undoubtedly place more emphasis on the evolving business patterns and the employment law issues that are of concern. However, our contribution to the consultation is focussed on tax and PRSI - highlighting the broad expanse of tax law and practice that already exists for intermediary arrangements and drawing attention to the possible unforeseen consequences of change which is not fully and carefully thought through.

From a tax perspective:

1. There is no one perfect tax and PRSI model that will cater for the wide range of complex intermediary arrangements that exist today and are continuing to evolve.
2. Proposed changes may have much wider consequences for the self-employed community and small owner-managed companies, who are not contractors operating through intermediaries.

Ultimately, each case is going to be unique. The tax status will always have to be judged on sound principles and on case law which recognises that there is no one simple approach,⁷ and based on the merits of the individual position.

⁶ IMF, "Labour Market Flexibility and Unemployment: New empirical Evidence of Static and Dynamic Effects"

⁷ Minister for Agriculture & Food v Barry & Ors (2008) IEHC216

The concerns about a loss to the Exchequer

The scope of the Consultation Paper that was published on 28 January is very broad. It focuses on a wide array of common work arrangements from self-employed individuals through to personal service (director-owned) companies and managed service companies (umbrella companies).

One of the key underlying assumptions in the paper is that there is a “loss” to the Exchequer from the working arrangements identified. This concern goes to the heart of the consultation but no details or even estimates have been provided on the quantum of the assumed loss and there is no analysis of how and where it is arising. It is not clear if evidence has been gathered to substantiate the extent of this “loss”, the key contributing factors and the key mitigating factors.

An ex ante evaluation of the existing loss to the Exchequer and of the measures proposed in the paper would help to properly quantify the extent of the existing “loss” and the costs and benefits of the proposals suggested, similar to the evaluations for tax expenditures, as outlined in the Department of Finance *Guidelines for Tax Expenditure Evaluation*.

The issues raised in the Consultation Paper

The paper outlines five specific areas where there appears to be a concern about leakage of tax or PRSI arising as a result of the working arrangements outlined above.

Issue 1 - Different outcomes in terms of employers’ and employees’ PRSI

It is correct to say that in Ireland, different work arrangements will give rise to differing PRSI treatment for both individual workers and employers. This is due to the different contribution rates that apply depending on whether a person is an employed contributor (Class A) or a self-employed contributor (Class S).

Much of the basis for the differing PRSI treatment has been determined by the Department of Social Protection (DSP) and set out in Social Welfare legislation.⁸

- Contractors who are working directors with a controlling interest (50%+ shareholding) in their own personal service company are insurable under Class S. Self-employed PRSI will be paid on their earnings at 4%. No employer PRSI is due.

⁸ Section 16 Social Welfare and Pension (Miscellaneous Provisions) Act 2013

- Contractors who are employees of an intermediary or agency are insurable under Class A. Employee PRSI of 4% and Employer PRSI of up to 10.75% will be paid on their earnings.
- The PRSI status of contractors who are working directors with a 50% or less shareholding of a personal service company or similar company will depend on the facts of the case. In practice, the experience of our members has been that these contractors are treated as Class A contributors in the main. As such, employee PRSI of 4% and Employer PRSI up to 10.75% will be paid on their earnings.

The class under which an individual pays PRSI is directly linked to the benefits they respectively receive. As illustrated below, Class S contributors are entitled to approximately 1/3 of the entitlements available to Class A contributors.

Entitlements	Class A	Class S
Adoptive benefit	Yes	Yes
Carer's benefit	Yes	No
Illness benefit	Yes	No
Health and Safety benefit	Yes	No
Invalidity benefit	Yes	No
Maternity benefit	Yes	Yes
Occupational injuries benefit	Yes	No
State pension (contributory)	Yes	Yes
Jobseekers' benefit	Yes	No
Guardian's Payment (contributory)	Yes	Yes
Treatment benefit	Yes	No
Widow, Widower, Surviving Civil Partner (contributory) pension	Yes	Yes

Again, the assumption in the paper is that a loss of PRSI specifically arises in situations involving intermediaries. However, measuring the extent of any loss, if there is indeed a loss, would be a complex issue. As well as determining the perceived PRSI leakage it should also take account of the other financial costs of altering the tax treatment including:-

- The size and economic contribution of the business population which uses contractors on project-based tasks to generate growth, tax yields and income.
- The extent to which the public sector accesses this specialist expertise and the cost savings achieved.

- The savings to the Social Insurance Fund from the reduced social welfare entitlements available to Class S contributors.
- The extent to which any perceived “underpayment” of PAYE/USC and PRSI is merely a timing difference rather than a permanent loss. We address this issue of timing differences in further detail below.

Included in any assessment of PRSI changes would need to be the estimated behavioural impact on MNCs for whom contract work arrangements are often an intrinsic part of the way they engage personnel. Many of these companies may have global choices about where they locate key R&D and innovation functions and indeed are looking very carefully at these options right now as they assess their business models in light of BEPS.

Issue 2 - Indefinite deferral of remuneration with a consequent deferral of tax/USC

It is important to be clear that Irish tax legislation and Revenue practice is very comprehensive in the breadth of measures it contains to ensure that:

- A. Any sum paid out of a company to a director/employee as salary or similar is fully taxable.
- B. Sums not immediately paid out of companies can still be liable to tax in a wide range of situations; and
- C. Extensive measures are available to Revenue to challenge the position adopted by an individual or company.

We have listed in Appendix I some of the key legislative provisions in the Tax Consolidation Act (TCA) and Revenue guidance that address these issues. In summary, there is very extensive legislation and guidance that is not reflected in the consultation paper but which operates to ensure that income cannot be deferred indefinitely in companies.

One of the options proposed by the paper is the imposition of a surcharge on undistributed profits of these companies. Irish legislation already applies a surcharge to undistributed profits of professional service companies under the “close company rules”, as outlined in Appendix I.

The imposition of additional corporation tax on the taxable profits of certain services sectors raises the risk of undermining the perceived transparency and stability of Ireland’s 12.5% corporation tax regime – which lies at the heart of Ireland’s international tax competitiveness.

We consider that the imposition of an additional corporation tax surcharge is not the appropriate means by which to address the concerns raised in the Consultation Paper. The proposed measure would adversely impact on the ability of companies to fund their businesses and reinvest for future growth. The Department of Finance Tax Strategy Group has acknowledged in the past, in the context of dismissing a proposal during Budget 2012 to

extend the current close company surcharge more generally to trading profits, that the imposition of a surcharge would have the effect of increasing the effective rate of tax on the retained earnings of companies affected and may have an adverse impact on the funding position of SMEs, who need to retain and reinvest business profits to generate future growth. SMEs are recognised as the key driver of employment growth, accounting for 68% of all employment, some 730,000 jobs.⁹

Measures (such as the imposition of a corporate surcharge or deemed distribution) which potentially provide a different tax treatment for cohorts of taxpayers providing equivalent services should be carefully evaluated. This is so that they cannot be said to provide a selective benefit for one type of service provider over another.

The proposed measure could appear to constitute an intervention by the State to confer an advantage on a selective basis to certain companies (i.e. the companies outside the scope of the proposed measures). Given that the proposed measure would potentially impact both directly and indirectly a wide range of sectors and companies operating in both the Irish domestic market and those engaging in cross border trade within the EU, the measure would have the effect of distorting competition by reducing the ability of companies affected by the proposals to compete and thereby conferring a selective benefit on a particular cohort of taxpayers (those not affected by the proposals) in the market.

In so far as there are ways to provide further clarity on the application of the close company rules, for example the scope of the professional services surcharge, the Institute would be happy to constructively engage in any such discussions.

Issue 3 - Payment of unwarranted tax-free expenses

In our view, there is an unfounded belief reported in the media that the scope to claim expenses is much broader than is actually the case. In fact, the rules are very narrow and tightly controlled through tax legislation, case law and Revenue guidance and practice. We have included a list of the key legislation and guidance on this topic in Appendix II.

Expense claims for travel and subsistence expenses in particular have been a keen area of focus for Revenue in recent years, most notably during the Revenue Contractors Project in 2013 and 2014. In the aftermath of that project, there has been widespread confusion on how to apply the tax rules for claiming travel expenses correctly. There are now six separate documents containing Revenue guidance on travel expenses for employees/directors. Much of the guidance is conflicting in nature, making it very difficult for businesses to be clear on the rules.

The Institute responded to the Department of Finance consultation in August 2015 on the tax treatment of travel expenses. We sought clarification in the legislation on a number of key issues, including the tax treatment of expenses for travel to temporary work locations

⁹ Financial Statement of the Minister for Finance, 13 October 2015

and travel in relation to home-based business. We also sought new Revenue guidance. We would welcome clarity on the issues raised so as to address current uncertainties.

Issue 4 - Pension planning opportunities

For valid social and economic reasons Government policy clearly encourages participation in private pensions by as many individuals as possible, to reduce reliance on the State. This is particularly important in supporting our aging population in light of the deficit in the Social Insurance Fund.

Tax relief that is available on pension contributions has been significantly curtailed since the start of the economic downturn. Tax relief has been reduced through the abolition of employer PRSI relief for employee contributions. The quantum that can be contributed to a pension fund has also been reduced given the reduction in the Standard Fund Threshold.

Tax relief represents a **deferral** of tax due rather than a loss of tax. Payments made out of a pension fund will ultimately be liable to income tax and USC when the payment is issued. Any perceived leakage of tax arising from a deferral of tax on pension contributions is a timing difference that will be reversed when the pension is drawn down.

There are differences in the quantum of pension contributions and the tax relief rules that apply depending on whether a person is self-employed or a director (or employee) of a company.

Self-employed individuals and employees with a Personal Retirement Savings Account (PRSA) are required to fund their own pension and obtain tax relief on these contributions up to the limits set in tax legislation.

In the case of a director (or employee) both the company and the individual can contribute to the pension fund. If a company makes a large one-off contribution in excess of its normal contribution, it cannot claim a tax deduction in full in the year the contribution is made.

Issue 5 - Tax planning opportunities

Ireland has a very extensive suite of legislation and Revenue powers to deal with perceived “tax avoidance”. We have a multitude of provisions which address any concerns about “misuse” of tax reliefs, extending to over a hundred pages of legislation, including:

- A General Anti-Avoidance regime, (in place since 1989).
- A Mandatory Disclosure regime as an “early warning mechanism”.
- A Protective Notification regime.
- A Qualifying Avoidance Disclosure regime.
- Over 20 specific anti-avoidance measures in legislation.

- Extensive Revenue powers, including powers to access information from third parties and to displace the general 4-year look back period in cases of suspected avoidance.

Tax law in this area is now so comprehensive so as to minimise any potential loss of tax to the Exchequer. Revenue also has highly developed systems to identify and challenge any tax planning it considers presents a risk to the tax yield. There are dedicated units focussed on monitoring and challenging suspected avoidance and increasingly sophisticated data analysis tools to identify risk areas.

Conclusion

In our view, we have a robust tax framework in place to address any perceived tax leakage, if it is taking place. In so far as there are ways to further improve our current regime, for example, through improved guidance the Institute would be happy to engage constructively in any such discussions.

It is preferable to focus on how to improve our existing framework for taxing labour, rather than introducing wholesale changes with the risk that these may result in consequences which could add further uncertainty to the tax regime, which is already undergoing significant changes.

Given that continued economic growth is vital to Ireland's economic recovery, it is essential that any measures do not hinder the current flexibility required in the Irish labour market. A cost-benefit analysis should be conducted to evaluate the full implications of any proposed reforms.

Appendix I

Issue 2 - Indefinite deferral of remuneration with a consequent deferral of tax/USC

We outline below the key current legislative measures which address this concern, together with a high level summary of the measures.

Legislative measures

S985/S985A – the obligations on employers to collect PAYE on pay and perks.
S986 – detailed tax regulations requiring employers provide information on all employees to Revenue and deduct and pay PAYE.
S989C-S989F – Revenue’s power to require an intermediary to collect PAYE if they are concerned it will not be operated by the employer.
S987 – penalties for breaching any of the PAYE regulations.
S988 – Revenue’s power to register a person as an employer if there is reason to believe they are an employer.
S989/S990 – Revenue’s power to estimate the tax they believe should have been paid and serve notice on an employer to pay it.
S996 – if unpaid remuneration is deducted as an expense PAYE is due.
S997/S997A – Revenue can deny certain directors credit for unpaid PAYE on salary resulting in the directors becoming liable for the PAYE due.
S1002 – Revenue’s power to attach wages to collect a tax debt.
The close company rules S430 – S441 which: <ul style="list-style-type: none">• apply a 15% surcharge to half the undistributed profits of a professional service company.• apply a 20% tax surcharge to loans to certain directors.• disallow a tax-deduction for expenses a company incurs for a shareholder. The payment is liable to Dividend Withholding Tax (DWT).• disallow a deduction for interest paid to a director shareholder if the interest is deemed excessive. DWT also applies.
S521 – the obligation on public bodies and similar to withhold tax at 20% on any payments made to contractors for professional services.
S20 – dividends are fully liable to income tax, USC and PRSI.

Revenue Guidance

eBrief No. 84/2011 - Tax and Universal Social Charge (USC) treatment of income arising from having or exercising the public office of director of an Irish incorporated company
Statement of Practice – IT/3/07 – Sets out employee payroll tax deductions in relation to non-Irish employments exercised in the State.
Revenue Manuals on the close company rules.
Revenue (PAYE) Employers Compliance.

Appendix II

Issue 3 - Payment of unwarranted tax-free expenses

There is detailed legislation and Revenue guidance to address any concerns of unwarranted claims for tax-free expenses.

The rules for the self-employed are outlined in the following key pieces of legislation and Revenue guidance:

S81 – the primary legislation which provides that expenses must be wholly and exclusively expended for the trade or profession.
Revenue Manual 04.10.01 – sets out case law on when travel expenses have been held to be incurred wholly & exclusively for the purposes of the trade.
Revenue Manual 04.06.17 – sets out case law on when food and accommodation expenses have been held to be incurred wholly and exclusively for the purposes of the trade.
Revenue Manual 11.00.02 – sets out the rules for claiming car running expenses where there is both business and private use.

The rules on the tax treatment of expenses in relation to directors and employees are outlined in:

Legislation

S114 – the primary legislation which provides that expenses must be incurred wholly, exclusively and necessarily for the employment to be tax deductible.
S117 – expenses paid to directors/employees must be taxed like a perk unless they are incurred wholly, exclusively and necessarily for the employment.
S118 – non-business expenses are not deductible in calculating a company's corporation tax bill.

Revenue Guidance

IT 51 – sets out the rules for the tax treatment of Directors'/Employees' Motor/Bicycle Expenses.
IT 54 – sets out the rules for tax treatment of Directors'/Employees' Subsistence Expenses.
Statement of Practice SP IT/02/2007 – Outlines the tax treatment for the reimbursement of Expenses of Travel and Subsistence to Office Holders and Employees.
Revenue's Employers Guide to taxing Benefits-in-Kind (BIK).
Extensive Revenue FAQs on the BIK rules on the use of company vehicles.
Revenue eBrief No. 48/2013 – guidance on Revenue's Contractors' Project.
Revenue eBrief No. 30/2013 – Further guidance on the reimbursement of travel and subsistence by intermediaries.
Revenue eBrief No. 61/2014 – guidance on the expenses of travel of non-executive directors attending board meetings.

Revenue eBrief No.63/2015 – guidance on the reimbursement of subsistence expenses to employees/directors in line with Civil Service rates.