



**Submission to the
Department of Finance
&
Department of Social Protection**

***'Use of Intermediary-type Structures and
Self-Employment Arrangements'
(Bogus Self Employment in Construction)***

Introduction

Congress has been to the fore in highlighting the issue of bogus self-employment for a number of years, most specifically in relation to the Construction Industry. When an appropriate response to our concerns was not forthcoming from the Revenue Commissioners we issued a report entitled *False Economy: The Growth of Bogus Self-Employment in the Construction Industry* (Winter 2015).¹

This consultation process has we believe, in part at least, been initiated in response to *False Economy*. As Congress has already commented comprehensively on these matters we suggest that this submission be read in conjunction with the earlier report. It is however appropriate to reproduce the Executive Summary of that report in its entirety.

False Economy: Executive Summary

Bogus self-employment in the construction industry has increased at an alarming rate in the last decade. The practice involves workers being incorrectly designated as ‘self-employed’ in order to save money for major contractors, in terms of tax and social insurance. This has had a number of very negative consequences for the workers concerned, for the industry as a whole and for wider society, resulting in very substantial losses to the State. Workers suffer the loss of employment protections and social insurance cover, while the wider industry sees an erosion of standards that make it less sustainable into the future.

Meanwhile, the State and citizens are deprived of substantial revenue in the form of lost PRSI contributions, taxes foregone and public money lost to unscrupulous contractors engaged in de facto fraud.

It is our view that a key contributory factor is the failure to adhere to a Code of Practice agreed by unions and construction employers, in a process hosted by Revenue. The revised Code of Practice for Determining Employment or Self-employment Status was agreed in 2007. The aim of the Code was to ensure that the Revenue systems designed to vet and assess applications for contractor status operated to the highest possible standard. However, bogus self-employment increased hugely in the years after 2007, strongly suggesting that the Code was not being adhered to.

In 2012, Revenue discontinued the old paper-based system and moved the RCT1 (Relevant Contracts Tax) process online. The pre-2012 system had stiff controls for applicants seeking ‘contractor’ status and alerted them to the loss of benefits and protections that could apply. However, those controls disappeared with the move online. Since then, the number of self-employed together with, bogus self-employed has further increased, in the construction sector. Given that the financial advantages of misclassifying workers as self-employed are immense, it is clear that some new form of control is required.

Major public contracts – as in the school building programme – are procured on the basis that established rates of pay and pension contributions will apply. However, when workers

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http://www.ictu.ie/download/pdf/false_economy_the_growth_of_bogus_self_employment_in_construction.pdf

are compelled to take on bogus self-employment status, those rates will often not apply and the ensuing differential is, we believe, retained by the contractors, while workers and taxpayers are short-changed. This practice reduces vulnerable workers to the status of 'day labourers' with no employment rights, while the State suffers substantial losses in PRSI contributions.

In this context, Congress believes it is a clear systematic error to allow 'principal contractors', who have a major vested interest, to retain the power of discretion in relation to employment status. The term 'principal contractor' is also misleading in that there can be any number of 'principal contractors' on a given project, often with no assets, no office and no employees. This lack of appropriate control and oversight effectively discriminates against good employers and facilitates those who want to substitute decent jobs with bogus self-employment, for short-term gain. Over the longer-term, only rogue employers benefit and everyone else loses out: Revenue, taxpayers, compliant contractors, the construction workforce and the wider industry.

It is ironic to note that employment agencies in the UK charge construction companies huge fees to facilitate their engagement in bogus self-employment. In this jurisdiction, systemic flaws and seeming political indifference means they get it for free.

Unless there is urgent action, the Irish construction industry will cease to be a source of decent employment and become a haven for sweated labour, where workers have no rights or social insurance cover. Ultimately, responsibility rests with policymakers who, to date, seem disinclined to ensure that labour standards are upheld, good jobs supported and public contracts are not a vehicle for fraud.

'False Economy' Focussed on Construction

Congress is well aware that bogus self-employment is a growing problem in many sectors. However, *False Economy* focussed on construction because we believe that Revenue's RCT1 system actually facilitates bogus self-employment. There is no need to set up 'a personal services company (PSC)' or 'managed services company (MSC)'. The 'principle contractor' is empowered to pronounce the job seeker to be self-employed. If the job seeker does not formally object to Revenue, a number of serious adverse consequences follow, such as loss of employment rights and social protection. While every job seeker may object, the Revenue Commissioners acknowledge that few do so. Why would any rational job seeker object to Revenue about the terms on offer and lose the work? Why would any employer offer a job, when a contract of self-employment is more financially attractive and avoids all obligations flowing from employment law.

The Consultation Document and the Congress Response

The consultation document contains separate sections numbered one to ten. Congress intends to comment on eight of these sections. For purposes of clarity we reproduce the original section of the consultation in italics followed by the Congress observation in bold.

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.

Congress Response

The strength of this consultation paper is that it seeks to address the loss to the Exchequer that may arise from bogus self-employment. The paper recognises that is a growing problem in many sectors of our economy. However the consultation paper is deficient insofar as it is concerned only indirectly with the loss of social insurance protection and employment rights. Nor is there any focus on the fraud, the market distortion and the destruction of decent employment which results from bogus self-employment.

The consultation paper betrays a certain diffidence both in its enigmatic title and in the fact that the term bogus self-employment appears nowhere in the text. It is ironic that the paper is prepared to acknowledge the existence of ‘a genuinely self-employed individual’ but surrounds bogus self-employment in euphemism.

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 legislation.

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.

Congress Response

There is useful information here regarding how bogus self-employment can be effected across a wide range of industries. It is our view that such practices are widespread in the Media and Media related sectors, and are also prevalent in IT, Pharma/Chemical Sectors. In the case of very higher earners the MSC option seems to be preferred. However at lower pay levels, particularly in Media, the worker often has little choice and for the most part the individuals concerned are employees in all but name. The contractor often demands compliance with the terms and conditions of employment applying to directly employed staff. However there is no need for a person in construction to set up a PSC or an MSC. The stronger or dominant party to the contract simply dictates the terms to the weaker dependent party. Unless the weaker dependent party formally objects to Revenue (which almost never happens) all the negative and adverse consequences follow.

An MSC is not structured solely for the purposes of avoiding ‘close company legislation.’ It is also designed to exploit the dependent weaker party. They become ‘labour only’ sub-contractors with no employment right, job security and little social protection.

3. Prevalence 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.

Congress Response

This information is accurate and of grave concern. Revenue is clearly well aware that bogus self-employment is widespread and growing. It is indeed positive that Revenue are actively engaging in this consultation process rather than perceiving itself merely as an observer. We have continuously highlighted the lack of concern by the State to whether the *Code of Practice for Determining the Employment of Self-Employment* is being adhered to. Indeed this been one of the central criticisms contained in our *False Economy* report.

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.

Congress Response

The section entitled 'Social Insurance Considerations' is descriptive and merely outlines the various PRSI contribution rates. The implications of bogus self-employment for our social insurance system are much more profound than this section would suggest. When a worker has finished a period of bogus self-employment he/she will usually have no entitlement to Job Seekers benefit, sick pay, redundancy and pension.

The losses to the State are such as to pose a threat to our entire social protection system. In *False Economy* Congress estimated that the State lost €640 million in PRSI contribution over eight years in construction alone. There can be no doubt that a future Social Welfare liability is developing which will require State funding. It is therefore vital that Revenue and the Department of Social Protection produce accurate information on the extent of these losses throughout the economy.

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.

Congress Response

The section is useful in that it identifies several ways in which bogus self-employment can lead to potential losses for the Exchequer. It also recognises that two individuals performing the same task can have different tax or social welfare outcomes. However such differences which lead Exchequer losses can result in financial advantage to the end user. The resulting market distortion, in the short term, displaces decent secure employment with bogus self-employment. Apart from the consequences referred to above, it is also worth noting that in the long term it will result in skill shortages. This is strongly evidenced in the Construction Sector where apprenticeships have all but ceased in the bricklaying and plastering trades which have been most affected by the abuse of RTC1s

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.

Congress Response

Congress fully concurs with what is outlined in this section. It should also be noted that very often the individuals concerned have little choice when offered a such a contract and

the RCT1 system gives the advantage to the stronger dominant party and places the weaker dependent party at an overwhelming disadvantage.

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.

Congress Response

Congress agrees that this is a complex area and that countries have reacted in different ways to the problem. However in Ireland no measures have been taken to address the issue. Through discussions with our colleagues in the ETUC and TUC we are aware that

these employment practices are a growing phenomenon across Europe. It is clear to us that as long as employers, end users and individuals are free to manipulate the Tax system to avoid costs associated with employer PRSI, pensions, sick leave, redundancy payment etc. then they will avail of them. The solution lies in closing off the opportunities to do so and providing strong financial penalty where such bogus behaviour is exercised.

The European Social Partners in the construction industry have agreed to two important principles that should be helpful in an Irish context:

- Unfair competition and social fraud are unacceptable in the construction industry and demand that these phenomena be eradicated using a combination of prevention, information and enforcement.
- That genuine self-employment requires specific legal, professional, financial and regulatory and administrative knowledge and skills as well as commercial risk taking. Allowing people to be registered as self- employed without this knowledge skills and acceptance creates unfair competition between genuine self- employed and bogus self-employed and distorts the construction market.

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:

- 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;*
- 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;*
- where an intermediary-type structure is in place, apply a surcharge to undistributed income of the intermediary; or*
- 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.*

Congress Response.

We concur that such options should be explored. If any combination of the above proposals have the effect of reducing losses to the Exchequer and ensuring a more transparent fair system which protects decent work, then Congress will support them.

Conclusion

Congress has already made several suggestions to improve the situation. The Code of Practice which we were to the fore in developing should not be ignored. While it is not the function or role of Congress to eliminate abuse and fraud from our tax and social protection

systems it is very much incumbent upon us to call halt when we see tax and social protection policies destroying good employment, denying the State of revenue, and building a future social welfare liability which will have to be funded. Congress therefore suggests the following principles which if accepted might lead to an improvement.

The decision to offer work as employment or a self- contract must not yield a financial advantage to the end user or the dominant stronger party.

- Contractors should be levied a sum equivalent to all PRSI liability repayable only upon satisfactory proof being provided on the employment status to Revenue.
- It should not be up to the jobseeker to complain about mis-designation
- All job seekers should be automatically treated as PAYE workers until they can prove that theirs is a contract for service.
- 'Labour only' subcontractors should be the subject of special focus and robust inspection.
- In construction there should be one principal contractor per project with everyone else either a subcontractor or an employee.
- General operative/ machine operators should never be regarded as self-employed.
- Revenue officials should be fully conversant with all aspects of the Code of Practice relating to bogus self- employment. and should have the power of initial decision as to whether or not self- employed status is appropriate.

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March 2016

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