Commission on Taxation & Welfare
An Coimisiún um Chánachas ⁊ Leas

Briefing Paper

Employment Disincentives

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Subject	**Employment disincentives in the welfare and tax systems**
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Version	Final
Date	Document last updated 29 October 2021

Key points

- The possibility that the taxation and welfare systems may, individually or in the way that they interact, generate unemployment or poverty traps is a long-running policy concern.
- While the core function of social welfare payments is poverty reduction, there is also a need to monitor replacement ratios, which are an incomplete proxy for financial incentives.
- The majority of people in receipt of social welfare payments have a strong financial incentive to work. This may be less the case for those on lower incomes, where the levels of pay are closer to what they receive in direct State supports, and for families with children, especially one-earner households.
- Some people may face work dis-incentives, particularly as regards the withdrawal of secondary benefits.
- There are elements of the tax code which introduce step-effects which may be problematic.

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1. Introduction

This paper follows previous discussions by the Commission at Meeting 4 (on how the tax and welfare systems facilitate employment) and Meeting 7 (on market income and redistribution).

The purpose of this paper is to highlight some key and specific elements of the tax and welfare systems that may act as a barrier to employment or reduce the financial incentive to increase earnings.

2. Executive summary

Policy decisions around the design of the tax and welfare systems may influence the financial incentive for individuals to maximise their employment capacity and increase their earnings by, for example, carrying out additional paid work and moving from part-time to full-time hours.

This is particularly the case for those on lower incomes, where the levels of pay are closer to what they receive in direct State supports, and for families with children, especially one-earner households.

A number of different policy decisions have been made within the systems that determine the extent that a charge is levied on employment income, as well as the extent that such employment income determines the level of support given through social welfare payments.

Certain aspects of means-tested social assistance payments may influence decisions individuals make about maximising their employment opportunities:

- The means-testing process itself may impact on the decision to take on paid work, if care is not taken around how such benefits are withdrawn as income from employment rises.
- The simple existence of social assistance and the security it affords, despite the minimal "safety net" income coverage, may also impact the extent to which an individual takes on employment.
- Certain secondary benefits have a more material impact on the financial incentives for employment than many of the above factors. The operation of the Medical Card, the National Childcare Scheme and Housing Assistance Payment have been identified as possible key factors in decision making around employment, specifically how access to these schemes is withdrawn as employment or earnings increase.

The application of the main charges relevant to employment income, namely income tax, USC and PRSI, determine how much of the additional employment income earned a person keeps. This may influence the choices around how much a worker chooses to work, how they choose to be rewarded for their employment services, or how their employer chooses to reward them. For example:

- Employer PRSI (ER PRSI) may influence the employer's decisions around which worker is given extra hours, whether to give extra hours of paid work in the first place, or to increase wages above the statutory hourly minimum.
- Employee PRSI (EE PRSI) may impact decisions workers make around whether to carry out additional paid work and their expectations around increasing their wages.
- The current structure of income tax bands and transferability of credits results in high marginal rates of tax for certain secondary earners in married households and reduces their incentive to take on paid work.

3. Social Assistance

3.1 Incentives to work (general)

As previously highlighted in the Introduction to the Irish social protection system paper at Meeting 2, the Irish social welfare system covers a range of contingency-based income supports, including means-tested social assistance payments, social insurance payments based on contributions history and universal payments, paid without regard to means or contributions.

The table below sets out the total numbers of recipients of the main social assistance schemes available for those of working age in 2019:

Table 1 Percentage of working HAP tenants (2018)

Scheme	Purpose	Number of recipients in 2019
Jobseeker's Allowance	Support for unemployed	138,867
One-Parent Family Payment	Bringing children up without the support of a partner	39,533
Disability Allowance	Substantially restricted from working because of a disability	146,755
Working Family Payment	Support for those on low pay with children	53,104
Carer's Allowance	Support for those on low pay who look after a person who needs support because of age, disability or illness	84,028

Source: Department of Social Protection Annual Report, 2020 (Table 4)

Most people in Ireland are better off in employment than in receipt of social welfare. Analysis of replacement rates[1] has typically found that the majority of live register[2] recipients will not experience a disincentive to move into employment as a result of their social welfare payment.

This may be less clear-cut for those with low earnings, as their income from employment may be closer to what they receive in direct State supports.

It is also less clear-cut for households with dependents - replacement rates are typically higher for families with children as a result of increased eligibility for additional allowances and benefits, with one-earner households particularly vulnerable in that regard.

3.2 Means-testing process

Some elements of means-tested social assistance payments may impact on the decision to maximise employment opportunities.

The "means test" process assesses if the applicant has enough financial resources to support themselves and determines the appropriate amount of social assistance payment, if any, the applicant may qualify for. The purpose of the means assessment is to maintain the policy of ensuring that social welfare expenditure is targeted to those who need it most.

Depending on the nature of the payment, the means testing assessment typically takes account of cash income (including any income from employment or self-employment and farm income) and capital (such as savings, investments and property other than the family home) belonging to the claimant and other family members who are living together, such as their partner (whether they are married or cohabiting).

The means-testing process includes employment income and so if employment income rises the benefits may be withdrawn, either partially or in full. The withdrawal of means-tested payments can create a disincentive to maximise employment capacity and create poverty traps, where a person and or their family are better off below a certain income threshold, or not employed at all.

[1] As discussed in the Encouraging Employment paper from Meeting 4, the replacement rate measures the financial incentive to be in paid work and is the proportion of earnings that is replaced by a social welfare payments.

[2] The live register is a monthly series produced by the CSO (dated back to 1967) which provides a record of the number of people registering for Jobseekers Benefit (JB), Jobseekers Allowance (JA) or for various other statutory entitlements with the Department of Employment Affairs and Social Protection.

It is for this reason that the means-assessment for all social assistance payments to those of working age have an income disregard[3] to minimise step-effects of return to work which might otherwise lead to withdrawal of the benefit.

An income disregard is a specified amount of employment income which is not taken into account when determining the benefits. The amount of the income disregard is typically set at a level that seeks to balance the need to provide a minimal level of support to alleviate poverty and deprivation while ensuring that the existence of the support itself does not unduly reduce the financial incentives of employment.

For example, the One-Parent Family Payment (OPFP) allows income of up to €165 per week from employment without resulting in a reduction in the social welfare payment. There used to be a weekly earnings limit of €425 for this payment which resulted in the withdrawal of the payment if weekly income went above this amount. This limit was removed in April 2021. Instead a more flexible criteria is now used that does not have a cap and that allows half of gross weekly income to be assessed as means so that a person may continue to qualify for a reduced payment.

This payment is targeted at lone parents, whose personal circumstances and responsibilities by their nature result in significant barriers to engaging with the labour market. Without this flexibility, a recipient of OPFP would need to ensure that their income from employment would be as secure as the social welfare payment and guarantee income equivalent to the maximum rate of payment that they would be entitled to per week (for example, €248 if their child is aged over 12). The flexibility of the updated approach affords the security of engaging with the labour market and increasing employment without risking the premature withdrawal of the level or security of the social assistance.

Different social assistance payments have different income disregards to reflect the nature of what the payment is trying to support and the associated economic burden to be overcome. The National Economic and Social Council (NESC) have highlighted the complexity of the welfare system, including the degree of variance across income disregards[4], as being something that makes it more difficult for an individual to move from welfare to work and that leads to decisions to stay with the certainty of their welfare payment.

NESC[5] also looked at the desirability and feasibility of merging various means-tested benefits for people of working age by introducing a single working age payment in Ireland. They concluded that there may be some merit in moving towards a more integrated payment structure on an incremental

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[3] There is a broad list of income that is not taken into account for means-testing assessment of cash income which can be viewed here.

[4] Ranging from €50 a week for Jobseeker's Allowance to almost €350 a week for Carer's Allowance.

[5] Towards a more integrated income support system, March 2021

basis. However they also noted that the implications need to be considered carefully, particularly in relation to retaining flexibility to tailor payments to meet people's needs, and that such a move would have to be complemented by adequate support structures and service provision.

3.3 Scheme design and in-work benefits

Social Assistance payments are intended to target support at those who need it most, in order to minimise expenditure while still alleviating poverty and deprivation.

Some payments may exclude employment by their very nature and design; for example, to qualify for Disability Allowance a claimant must be substantially restricted because of their disability[6] from doing work that would be suitable for a person of their age, experience and qualifications.

Another example is that one of the primary conditions to qualify for Jobseeker's Benefit (JB) and Job Seeker's Allowance (JA) is that you must be unemployed. JB and JA require recipients to be available for and actively seeking work, with the ultimate goal being to maximise employment capacity and undertake full-time work.

To recognise that part-time work may be the first-step towards full-time hours and to encourage any engagement with the labour market, JB and JA may be claimed where the person works up to 3 days in a week. The value of the weekly payment is gradually withdrawn on a tapered basis per day worked and is fully withdrawn if the recipient works for more than 3 days in the week. If someone works more than 3 days in a week they therefore are not entitled to JA or JS.

As with the income disregards, the flexibility that allows for a certain number of days to be worked affords the security of some engagement with the labour market and increasing employment without risking the premature withdrawal of the level or security of the social assistance payment.

The decision to move from welfare to work relies on the financial advantages and balanced against the loss of the security of the welfare safety net. It may be particularly close run for those on lower pay or who require more flexibility around working hours.

In some circumstances it is possible for recipients to combine both – to continue to claim benefits, even when in work with a view to ultimately increasing employment capacity to a level that no longer requires State support.

[6] Have an injury, disease or physical or mental disability that has continued for at least one year or is expected to continue for at least one year, following a medical assessment.

Such "in-work" supports are a feature of the social assistance system, such as the Working Family Payment (WFP). This is a weekly payment that gives extra financial support to families with children depending on their incomes and family size. It is available to employed parents who work 38 or more hours per fortnight and the amount of WFP recipients receive is 60% of the difference between the income limit for a family of their size and their actual income. The WFP operates to reduce the replacement rates of families by increasing their in work income at low wage levels and has been found to be particularly effective in maintaining incomes and lowering replacement rates[7].

As discussed above, it is possible to claim JA and JB when in certain part-time work and the prevalence of part-time workers supported by jobseeker claims has increased in general since 2009, against a backdrop of considerable turbulence in the labour market.[8]

Welfare support for part-time work has advantages – for example, there is evidence that part-time work is a stepping stone towards full-time employment and that in an economic downturn part-time work (as an alternative to becoming wholly unemployed) maintains jobseekers' skills and sectoral experience, expands their network of contacts and preserves or enhances the soft skills required in the workplace.

However, there are potential disadvantages to subsidising part-time work, for example, the provision of part-time income support could inadvertently shift part of the cost of maintaining employees to the State resulting in increased expenditure, it may moderate an employer's incentives to convert part-time to full-time positions (for example, the risk that the employee will leave for full-time work elsewhere) and prolong the existence of low hours and lower pay. Care is also required to ensure that it does not act as a long-term support for inefficient firms by hindering the reallocation of labour from less productive firms to more productive firms.

Activation policies may have a more meaningful impact on helping recipients of certain types of payments to maximise their employment capacity. The topic of activation will be revisited in a future paper.

3.4 Security of payment

The simple existence of the safety net of social assistance may also impact the extent to which an individual takes on employment.

[7] IGEES Staff, 2018
[8] IGEES staff paper, 2017

As mentioned above, the decision to move from welfare to work logically requires a consideration of the short-term financial incentive to work - whether the income from employment is more than the person would receive in social welfare.

Another consideration is whether the income is as predictable and secure as the defined weekly social welfare payments and supports. This is especially the case when dependents (such as children) are taken into consideration, as the risk of the security of employment income has consequences for the whole household.

Given that the income support provided by the social assistance system is set at minimal "safety net" levels, there is little, if any, scope to reduce that support without running the risk of increasing poverty and deprivation.

4. Secondary Benefits

There are a number of secondary benefits in Ireland that are available to workers and which impact on the expenses to be met out of their overall income.

Previous papers discussed by the Commission[9] have considered how people can return to work from periods of unemployment or increase hours from part-time to full-time.

Ireland delivers income support primarily through the social insurance model (discussed in the accompanying Social Insurance paper) and the social assistance model (which focuses on point-in-time need, without reference to employment history).

In the past, people in receipt of a primary income support payment were also eligible for secondary benefits (subject to eligibility criteria). Eligibility for more recent initiatives, such as the National Childcare Scheme (NCS), is based not on receipt of a primary payment but on household income levels, including from employment.

This trend, of providing access to benefits on the basis of household income levels, rather than employment status, is intended to alleviate disincentives for households to either take up work (where employment is not financially advantageous in the short term) or to increase work (where doing so triggers some combination of benefit withdrawal and tax that makes them less well off). The trade-off is that policy design is more complex and requires careful interaction of income thresholds and other criteria.

[9] At Meeting 2 (overview of the tax and welfare system), Meeting 4 (on how the tax and welfare systems facilitate employment) and Meeting 7 (on market income and redistribution).

As a consequence, the relevant population for these benefits (discussed below) is a broader cohort than just people in receipt of social assistance payments. Given the level of the income threshold, the withdrawal of these benefits will affect households at income levels considerably higher than the personal rate of a social assistance payment. Some of these people may, subject to other criteria, be in receipt of in-work support.

Although these individual secondary benefit schemes may be outside the social assistance system on the basis that they are not administered by the Department of Social Protection, their impact is relevant to decisions taken around how much someone works, or whether they chose to work at all, and may have a more material impact on employment than the tax and welfare systems.

And although the inclusion of employment income in these schemes is appropriate to target the support at those problems and minimise the cost of individual schemes, in the event that employment income increases, access to a scheme may be withdrawn either entirely or on a tapered basis.

For example,[10] if a single parent with a 2 year old child has been working three days a week and has annual net income of just under €26,000, the subsidy they receives under NCS is around €10,000. If that parent is considering whether to increase their paid employment and work a full-time 5 day week, they would expect an increase in their income to around €43,000, but would get a lower subsidy under the NCS of just under €6,000. This would reduce their overall gain in net income from just over €17,000 to just under €13,000. At the same time, the parent may actually be facing increased childcare costs for the extra two days they would be at work. This choice may be further complicated by the interaction with any other income based entitlements which could also be withdrawn as a result of the employment income going up.

The secondary benefit schemes considered most relevant to the work of the Commission have been identified and set out below, covering housing, health expenses and childcare.

4.1 Housing Assistance Payment Scheme

The Housing Assistance Payment (HAP) scheme is a measure that supports households that qualify for social housing within the private rental market and allows tenants to work full-time while retaining their housing supports. It is administered by the Department of Housing.

[10] Note: this is a simplified example for illustrative purposes only, based on annualised subsidy figures, assuming the tax rates remain the same and all elements of the NCS scheme are maximised

Any household that qualifies for social housing support and is not currently housed by their Local Authority (LA) can apply. Based on the criteria used to determine whether someone qualifies for social housing,[11] HAP is available for single person households with net income of €35,000 (approximately €50,000 gross per annum).

Under the scheme, HAP tenants must find their own accommodation in the private rented market and enter into a rental agreement with the landlord. The LA makes a monthly payment to a landlord on a HAP tenant's behalf, up to a certain threshold of rent that is set within the relevant LA. Limits for HAP payments are based on the number of people in the household and the rental market in the locality. There is limited additional flexibility afforded to LA's to exceed rent limits by up to 20% on a case-by-case basis.

Table 2 Range of rent limits allowable for different types of households across all LAs[12]

	1 adult shared accommod	Couple shared accommod	1 adult	Couple	Household with 1 child	Household 2 children	Household with 3 children
Monthly limit	€180 - €430	€200 - €500	€330 - €660	€350 - €900	€400 - €1,250	€425 - €1,275	€450 - €1,300
Annualised figure	€2,160 - €5,160	€2,400 - €6,000	€3,960 - €7,920	€4,200 - €10,800	€4,800 - €15,000	€5,100 - €15,300	€5,400 - €15,600

Source: Citizens Information see also Gov.ie table of income limits

Broadly speaking there are three income bands which the 31 local authorities apply in relation to the maximum net income threshold for HAP these are: €35,000, €30,000 and €25,000 for a single person and €42,000, €36,000 and €30,000 for a three adult and four child family.

The HAP tenant pays a weekly contribution towards the rent to the LA. This 'rent contribution' is based on household income and is calculated in the same way as rent paid by a tenant of a local authority property - the weekly rent is calculated as a percentage of the assessable household income, with deductions applied for dependents[13], including family members. The criteria for determining

[11] The level of HAP provided is based on a household means test which takes account of the net average income from a variety of sources (these are specified by each LA), including from employment and social welfare (net of income tax, PRSI and USC where applicable) in the preceding 12 months prior to the date of receipt of application. Detailed guidance is here.

[12] Note: The rent limits set by local authorities are based on monthly thresholds. These have been annualised in the above for illustrative purposes only.

[13] Dependents include children, old-age pensioners and a person on disability allowance.

assessable household income varies by LA, but generally includes income from social welfare payments.

There has been a significant uptake in HAP recipients since it was first introduced in 2014. Net Exchequer expenditure on HAP has increased significantly since its introduction, from €0.39 million in 2014 to €382.4 million in 2019.[14] This increased to €464 million in 2020. The increase is partly due to people moving from the Rent Supplement to HAP.

Over this time, the proportion of working HAP tenants earning over €30,000 (annual gross income) has increased from 5.8% in 2015 to 14.4% in 2018. Table 2 shows the percentage of working HAP tenants earning different levels of income in 2018 (the most recent data available).

Table 3 Percentage of working HAP tenants (2018)

Income Group (Gross Household Annual Income)	Percentage
Up to €4,999	19.3
€5,000 - €9,999	17.8
€10,000 - €14,999	16
€15,000 - €19,999	12.1
€20,000 - €24,999	11.5
€25,000 - €29,999	8.8
€30,000 - €34,999	6.9
€35,000 – €39,999	3.8
€40,000 - €44,999	2.2
€45,000 - €49,000	0.8
€50,000 and above	0.7

Source: The Central Statistics Office (CSO)

4.2 Medical Card

Medical Cards[15] issued by the Health Service Executive (HSE) allow card holders and their dependent children and spouse to receive certain health services free of charge.[16]

[14] data.gov.ie (based on data published by the Department of Housing, Local Government, and Heritage). IGEES Trends Analysis Housing Assistance Payment (2014 – 2019) (October 2019).

[15] HSE website

[16] "Full" Medical Card holders are entitled to GP visitation, prescription services (cost of regular and high-tech drugs and dispensing fees), and dental and ophthalmic care. GP Visitation Card holders are entitled to primary GP care under the scheme.

Medical card eligibility is determined on the basis of either means-assessment or discretionary allocation:

- The majority of medical cards are issued based on means-tested income assessment at the family or tax unit level, ensuring medical care is available to individuals and families without the means to procure it privately.
- There are also specific categories of non-means tested eligibility, such as participation in certain government schemes as well as other personal circumstances – for example, for under sixes and over seventies and people in receipt of carer's allowance in respect of GP cards.
- Additionally the HSE issue discretionary cards to individuals who do not meet eligibility criteria, however due to their specific individual circumstance are deemed eligible for cover. Discretionary cards account for around 10% of medical cards issued and are given out where there is determined to an inordinate level of spending on medical services, usually where there has been a serious illness diagnoses or multiple illnesses within a family.

The means-assessment threshold is based on weekly net income, after expenditure on mortgage/rent, childcare and work commuting costs[17]. The qualification threshold varies depending on the applicant age, habitation status, and number of children as set out below in Table 3, which also includes the (higher) threshold for GP visitation card means-assessed eligibility:

Table 4 Means Assessment – Weekly Net Income Thresholds for Medical Cards and GP Visit Cards[18]

Living Situation	Medical Card (weekly net income)	Medical Card (annualised net income – for illustrative purposes only)	GP Visit Card (weekly net income)	GP Visit Card (annualised net income – for illustrative purposes only)
Single person living alone aged up to 65:	€184	€9,568	€304	€15,808
Single person living alone aged 66 and over:	€201.5	€10,478	€333	€17,316
Single person living with family aged up to 65:	€164	€8,528	€271	€14,092
Single person living with family aged 66 and over:	€173.5	€9,022	€286	€14,872

[17] Cash income, savings, investments and property (except for the family home) are taken into account in the means test.
[18] Note: The net income thresholds for the medical card means test are based on weekly net income. These have been annualised in the above for illustrative purposes only.

Married, co-habiting couple/single parent family aged up to 65 with dependents:	€266.5	€13,858	€441	€22,932
Married, co-habiting couple/single parent family aged over 66 with dependents:	€298	€15,496	€492	€25,584
Additional allowance for first two children under 16 financially dependent on applicant:	€38	€1,976	€57	€2,964
Additional allowance for 3rd and subsequent children under 16 financially dependent on applicant:	€41	€2,132	€61.5	€3,198
Additional allowance for first two children over 16 financially dependent on applicant:	€39	€2,028	€58.5	€3,042
Additional allowance for 3rd and subsequent children over 16 financially dependent on applicant:	€42.5	€2,210	€64	€3,328
Additional allowance for dependent over 16 who is in full time 3rd level education, not grant aided:	€78	€4,056	€117	€6,084

Source: Health Vote, DPER Spending Review 2019 Costing Framework for the Expansion of GP Care (October 2019)

If the circumstances of an individual who is in receipt of medical card change, they must inform the HSE as they may no longer be eligible; for example if a person's income or family circumstances change. If a person in receipt of a medical card returns to work they may be able to retain the medical card for three years from beginning in employment. In this case, the individual must have been receiving full social protection payment or Government employment scheme payment for the preceding 12 months. After this period of three years, if the person continues working they must complete a review of their eligibility for a medical card. As previously noted, eligibility for a full medical card also gives an individual entitlement to a reduced rate of USC of 0.5% on income up to €12,012 and 2% on all income over €12,012.

A significant proportion of the population have a medical card - at the end of 2020, almost 1.6 million people in Ireland held a full medical card and almost 530,000 held a GP card, covering 33% and 44%

of the total population of 4.9 million respectively. The level of HSE expenditure on the scheme in 2020 was €3.6 billion.

The absolute numbers of card holders has increased since January 2014 (driven primarily by policy decisions to expand the GP scheme to under 6s and over 70s in 2015) while the absolute number of medical cards has consistently trended downwards over this period. The downward trend in medical cards is driven by improving in economic conditions (falling unemployment and increasing income) following the downturn.

4.3 National Childcare Scheme

The National Childcare Scheme (NCS)[19] provides two types of childcare subsidy, paid direct to Tusla registered childcare providers[20], for children over six months of age. It is administered by the Department of Children and Youth Affairs.

There is a universal subsidy for children who are over 6 months and under three years old, which is not means tested. The universal subsidy is paid at €0.50c an hour, up to a maximum of 45 hours a week in respect of all eligible children.

The income-assessed subsidy is available to children aged from six months up to 15 years of age. This means tested subsidy is based on the net "reckonable income" of the family of up to €60,000 per annum (approximately €97,000 per annum in the case of a single PAYE household):

- Reckonable income is the total net household income from all sources, including most social welfare payments, after tax, PRSI and USC have been deducted.
- There are a number of allowable deductions which are not included in the calculation of reckonable income, such as pension contributions and certain social welfare payments including exceptional needs payment.[21]
- The family criteria is broadly household based, including the income of a couple who may be married or cohabiting, even if the partner is not the child's parent or legal guardian.

Hourly subsidy rates are based on individual circumstance (reckonable family income, age and educational status of child):

[19] National Childcare Scheme website
[20] And subtracted from the overall bill.
[21] https://www.ncs.gov.ie/en/faqs/

Table 5 Income Assessed Subsidy – National Childcare Scheme Rates[22]

Reckonable Income	Rate per hour (0 – 1 years)	Annual Rate (0 – 1 years) (Illustrative only)	Rate per hour (1 – 3 years)	Annual Rate (1 – 3 years) (Illustrative only)	Rate per hour (over 3, not yet in school)	Annual Rate (over 3, not yet in school) (Illustrative only)	Rate per hour (school age and up to 15)	Annual Rate (school age and up to 15) (Illustrative only)
Under €26,000	€5.1	€11,934	€4.35	€10,179	€3.95	€9,243	€3.75	€8,775
€27,500	€4.9	€11,466	€4.18	€9,781.2	€3.78	€8,845.2	€3.58	€8,377.2
€32,500	€4.22	€9,874.8	€3.61	€8,447.4	€3.19	€7,464.6	€3.03	€7,090.2
€37,500	€3.54	€8,283.6	€3.05	€7,137	€2.61	€6,107.4	€2.48	€5,803.2
€42,500	€2.87	€6,715.8	€2.48	€5,803.2	€2.03	€4,750.2	€1.93	€4,516.2
€47,500	€2.19	€5,124.6	€1.92	€4,492.8	€1.45	€3,393	€1.38	€3,229.2
€52,500	€1.51	€3,533.4	€1.35	€3,159	€0.87	€2,035.8	€0.83	€1,942.2
€57,500 - €60,000	€0.84	€1,965.6	€0.78	€1,825.2	€0.33	€772.2	€0.33	€772.2

Source: Citizens Information

During school terms, subsidised hours can be used for both before-school and after-school childcare costs. The number of childcare hours that are subsidised depends on the number of hours the household works, or engages in study or training:

- If the household is working, studying or training there is an entitlement of up to 45 hours of subsidised childcare per week (enhanced hours subsidy).
- If the household is not working, studying or training, it is possible to qualify for up to 20 hours of subsidised childcare per week (standard hours subsidy).

Since the beginning of NCS operations in November 2019 up to 24 August 2020, 42,557 households received the subsidy and approximately 70% of which were income assessed subsidies[23].

[22] Note: The hourly rates have been annualised in the above for illustrative purposes only (on the basis of the maximum 45 hours per week).
[23] https://www.gov.ie/en/publication/66671-annual-early-years-sector-profile-report-201920/

4.4 Impact of Secondary Benefits on Work Incentives

These secondary benefits have a material impact on the financial incentives for employment. The main criteria of these schemes are set out above, but in the case of a married couple aged under 65 with two children under 6 the following summarises the criteria[24]:

Table 6 Summary secondary benefits criteria

	NCS	Medical Card	HAP
Maximum household income, including from employment	€60,000 (net)	€15,834 (net)	€42,000 (net)
Other income included/excluded/allowances	Includes social welfare payments	Excludes certain social welfare payments, allowance for housing & childcare costs	Includes most social welfare payments,
Assessment period	Previous tax year	Weekly income	12 months prior to application
Range of support per annum	€772 - €11,934	Non-cash benefit	€5,100 - €15,300
Number of households supported	42,557(2020)	1,574,507 (2018)	57,630 (2019)

As with social assistance payments, in order to minimise State expenditure and target the support at those who need it most, these schemes are designed to identify those who have the least means of their own to cover the cost of housing, medical expenses or childcare. And although the inclusion of employment income is appropriate to target the support at those problems and minimise the cost of individual schemes, in the event that employment income increases, access to a scheme may be withdrawn either entirely or on a tapered basis[25].

The simple use of employment income as a criteria for qualification for such schemes could therefore undermine the financial incentive for individuals and households to maximise employment capacity. However, this criteria may be preferable to basing eligibility on the employment status of the person or whether they were in receipt of a primary social welfare payment, which was historically the position.

The position vis-à-vis employment and secondary benefits is nuanced. For example:

- The proportion of working HAP tenants earning over €30,000[26] has increased in recent years from 5.8% in 2015 to 14.4% in 2018. Therefore the existence of the scheme, which is notably

[24] This summary is indicative and provided for illustrative purposes only
[25] In the event that a household has qualified for more than one of these schemes, they could face a simultaneous withdrawal of more than one of the schemes at the same time.
[26] Annualised, gross income

in line with social housing criteria, may not necessarily preclude someone from engaging in employment, or increasing their income up to a point.

- Access to affordable childcare is typically a prerequisite to maximising the employment capacity of households with children – and the NCS is specifically in place to provide financial support to help with childcare costs.
- The Medical Card typically remains in place for 3 years after a person originally qualified, which is particularly useful for those returning to work or increasing their employment. As the Medical Card gives a non-cash benefit, it may be harder to replace with employment income. The security of coverage of a Medical Card, depending on the health needs of a household may also impact on their choices.

These schemes are all administered by separate Departments[27] and the differences in the criteria used to determine qualification for each scheme raise complexity for households who may be making decisions on their employment opportunities.

Although all three schemes generally take account of employment income, there is variance around the account taken of social welfare payments, as well as other household expenses and variance in the level of financial support (albeit likely reflective of the cost of the measure it is trying to address).

All of these elements impact on of the amount of after-work disposable income in a household for both existing recipients and potential future recipients.

5. Application of tax charges to employment income

There are a number of elements of the charges to income tax, USC and PRSI that may impact on how much workers chose to work, how they chose to be rewarded for their employment services, or how their employer chooses to reward them.

Income tax, USC and employee PRSI (Class A) all generally apply to income from an "employment" i.e. emoluments[28], including share based remuneration[29] and Benefits-in-Kind (BIK) where an employer makes certain payments on behalf of an employee.

As discussed in previous papers, Ireland has a progressive income tax system with the tax charge increasing as earnings increase.

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[27] Department of Children and Youth Affairs (NCS), Department of Health (Medical Card) and Department of Housing (HAP)

[28] Wages, salaries

[29] Note share based remuneration is not subject to ER PRSI

5.1 Steps effects - Employer PRSI

As highlighted in the Encouraging Employment paper from Meeting 4, there is a step effect within the employee charge to PRSI, and actions have been taken to smooth out the step effect via the PRSI credit.

There is an additional step effect that has been highlighted several times by the Low Pay Commission, most recently in their 2021 Report. In the context of considering increases to the National Minimum Wage (NMW), they found that even a modest increase in the hourly NMW could bring a cost to the employer that is six times the benefit to the employee. This is because the ER PRSI charge is levied as follows[30]:

- A rate of 8.8% is applied on earnings up to €398 per week
- A rate of 11.05% on entire earnings where earnings exceed €398 per week

A €0.01 increase in gross wages for an employee earning a gross wage of €398[31] brings the gross wage to €398.01 per week and triggers an additional €8.96 per week ER PRSI contribution/liability (on top of the €35.02 already being paid), for the increase of €0.01 to the employee's gross wage. This represents a significant disincentive on the employer to pay for extra work. It may impact on their decisions around which worker is given extra hours (relevant for underemployed workers) or whether to give extra hours of paid work in the first place, or to increase wages above the statutory hourly minimum.

It is for this reason that, if there is an increase in the National Minimum Wage (NMW) there is also a corresponding increase in the threshold at which the higher rate of PRSI applies (due to move from €398 to €410 per week from 1 January 2022) to ensure that there is no incentive to reduce the working hours for a full-time employee on the NMW.

It is estimated that there are around 120,000 workers in Ireland who are on the NMW[32] who may be impacted by this step (though they may not all work full-time). This would also impact on workers who earn above the NMW but who work part-time with income around €400 per week.

[30] Class A PRSI, following Budget 2022, this will rise to €410 per week from 1 January 2022
[31] A full time minimum wage worker undertaking 39 hours paid work earns €397.80 per week
[32] CSO, 2019 data

5.2 Married households with one income

The design of the income tax system also has a step-effect that applies in the case of married couples[33] with only one income[34]. For historic reasons, a higher income tax standard rate band[35] applies in the case of married couples with one earner (currently €44,300 rising to €45,800 after Budget 2022) when compared with a non-married one earner household (whether cohabiting or single).

Pre-2000, there was full transferability of income tax credits and rate bands between married couples. The primary earner was able to use the combined tax credits and standard rate band available to both individuals – i.e. double the personal tax credit and rate band available to a single earner. The result of this position, however, meant that if there was a change in the employment status of the other spouse, they had less personal credits and bands to use and therefore faced higher marginal rates of tax on their employment income than their primary earning spouse did.

It is well established that this acts as a disincentive to workforce participation for second earners, who are typically female[36]. Over the last few decades, the general trend in European Union countries has been a move from joint towards individual taxation on the grounds that it increases the labour market participation of secondary earners and improves equality and economic independence for women.[37] The process of making a similar move in Ireland began in the 2000/2001 tax year, with the stated economic objectives of increasing labour force participation overall and reducing the numbers of workers paying the higher rates of income tax. It was met with political opposition[38] and so the process was only partially completed such that the current situation is that tax credits and bands may be partially transferred between spouses.

The disincentive to work therefore remains in the income tax system such that as a single income household moves to a two-income household, a higher marginal rate of tax applies to the second

[33] Note: all references to the tax treatment of married couples also applies to those in civil partnerships

[34] The additional ability to transfer personal credits further increases the step, as may the withdrawal of the home carer credit if being claimed.

[35] The income level where the higher 40% rate of income tax applies rather than the standard rate of 20%.

[36] For a married couple under joint assessment, the assessable spouse is determined not by gender but typically by reference to the higher earner of the couple. Notwithstanding this gender neutral approach, earnings and workforce participation data indicate that males are more likely to be the higher earners in households and therefore usually the assessable spouse. Therefore, policy measures targeted at the secondary earner of a jointly assessed couple could be expected to have a more significant impact on females.

[37] Luxembourg Institute of Socio-Economic Research, 2020

[38] This move was paused when met with political opposition, in particular on behalf of single-income families with caring responsibilities in the home. The Home Carer Credit was therefore introduced and the process itself was never fully completed. The HCC has been almost doubled between 2015 (when it was €810) to the current level of €1,600, while the position on the transferability of personal credit and bands has remained unchanged.

income - for example, in the case of women who are considering a return to paid work after an extended period of caring.

In 2018[39], there were around 440,000 married one income households in Ireland. A substantial majority (around three quarters) had less than €50,000 gross income in that year and around 100,000 had income between €35,000 - €50,000.

This policy that reduces labour participation by second earners could now be given renewed analysis for a number of reasons. These include, the need fund future expenditures on health and pensions while also dealing with the challenges posed by stagnating labour force participation, population ageing and housing pressures, and the impact the policy has on the longer term financial position on women who typically have shorter and less well-paid careers and also lower pension entitlements[40]. An individualised system equalises the marginal tax rates of the primary and secondary earner on their first Euro of income, so that both are equally encouraged to work.

It should also be noted that this treatment is only available to married couples and excludes cohabiting couples. This is relevant to a broader examination of family circumstances and choices, and employment.

5.3 Operational step effects

All three charges (Income tax, USC and PRSI) are collected by the Revenue Commissioners, primarily through the real-time Pay As You Earn (PAYE) system. Under this system, as and when workers are paid by their employer, the employer withholds the taxes due on the income and remits such taxes to Revenue on behalf of the worker. The worker remains responsible for ensuring their final end of year liability is correct[41], but in the case of most employees whose only income comes from their employment the PAYE system operates effectively to ensure their tax liabilities are discharged.

This system is efficient from both the State's perspective, as well as the workers as it allows for the real-time payments of taxation throughout the tax year and minimises any adjustments that may be required to deal with any under or overpayment of taxes at the end of the tax year.

Social welfare payments are paid out by the Department of Social Protection and for policy reasons PAYE is not operated on such payments. Instead the tax is typically collected at the end of the tax

[39] CSO Revenue data, most recent available
[40] Taxation, work and gender equality in Ireland, Dooley, 2018
[41] At the end of every tax year Revenue makes available to employees an Employment Detail Summary and a Preliminary End of Year Statement (PEOYS)

year or through the PAYE system (usually by adjustment of tax credits) if or when a person is able to return to work. In the case of individuals returning to work, this may result in a lower take home pay as tax will also be collected on the on-going employment income, as well as for the social welfare income they had previously received. This return to work liability "overhang" has been particularly visible and impacted a high number of taxpayers from 2021 following the introduction of the Pandemic Unemployment Payment (PUP) in March 2020 in response to the restrictions on the economy that were introduced to counter the spread of Covid-19[42].

Although the scale of the impact in 2020 may not be typical, the usual churn in the live register within a year in particular is noted, with 100,000 people typically moving between work and welfare and potentially impacted by this step. At the same time, a change in this area would need to be balanced against how the operation of PAYE on social welfare payments could reduce the amount of income supports given to recipients when the welfare rates are already set a minimal safety net levels only. It may therefore remain preferable and more manageable for the tax to be collected when in work to reduce the risk of poverty and deprivation when on social welfare.

[42] Based on data published by Revenue in January 2021, only 10% of the 790,000 taxpayer units who had received support via the PUP or Temporary Wage Subsidy Scheme over the year had a balanced liability by the end of the 2020 tax year. Revenue have had to put in place special arrangements to allow for the outstanding liability to be collected over 4 years beginning in 2022.

6. Conclusions and questions

Taking account of the elements discussed in this paper, views of the Commission on the following are invited to inform further work by the secretariat.

Do the Commission consider that, at present, the Irish tax and welfare systems have significant barriers to labour force participation? What is the nature and extent of the problems that members think should be addressed?

What areas of the tax and welfare system do the Commission think would be most impactful to address and why? For example:

- *The principles and uniformity of the social assistance means-testing criteria*
- *The step effects in the charge to PRSI*
- *The higher SRCO and associated income tax flexibility for married one-earner households*

Do the Commission think that secondary benefit schemes should make better provision for changes in employment and income without premature withdrawal of the benefit?

Are there further issues in the tax and welfare system relevant to employment that have not yet been addressed that should also be considered and why?