The Taxation of Non-standard Work

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The Taxation of Non-standard Work: Project Overview

• This project considers the role of tax in influencing employment form

• It takes stock of the employment forms that exist in a country and analyses the tax treatment of each, inclusive of social contributions
  – Two perspectives:
    1. Individuals’ choice of organisational form
    2. Firms’ choice of which labour contract to extended to workers
  – Eight countries:
    • Argentina, Australia, Hungary, Italy, the Netherlands, Sweden, the UK and the US

• To be published as an OECD Working Paper in January 2019
Tax Design Principles Applied to Employment Form

• **Equity:** Tax should be “fair” for all taxpayers
  – Horizontal equity: individuals carrying out similar activities and deriving similar income from these activities should face the same tax liabilities
    => employees and the self-employed should be taxed similarly
  – However, fundamental differences between employees and the self-employed warrant departures from horizontal equity
    • Benefit entitlements: if a self-employed worker is not entitled to the same future benefits as an employee, he/she should pay less tax

• **Efficiency:** Tax should not distort behaviour
  – Evidence that tax affects choice of employment form, how to take income
  – Opens avoidance opportunities and requires rules to police boundaries
Tax Treatment & Employment Form: Stylised Cases

**Case 1 – Standard Employee**

A firm hires a worker as a standard employee.
Labour cost typically consists of:
- Wage
- Employer social contributions

An employee is hired under a standard employment contract.
She/he is typically liable for:
- Personal income tax
- Employee social contributions

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**Case 2 – Unincorporated Self-employed**

A firm hires an unincorporated self-employed worker as an independent contractor.
Labour cost typically consists of:
- Wage
- *No employer social contributions*

An unincorporated self-employed worker is hired as an independent contractor.
She/he is typically liable for:
- Personal income tax
- *Social contributions paid on own behalf*

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**Case 3 – Incorporated Self-employed**

A firm hires an incorporated self-employed worker as an independent contractor.
Labour cost typically consists of:
- Wage
- *No employer social contributions*

An incorporated self-employed worker is hired as an independent contractor.
She/he is typically liable for:
- Personal income tax
- On labour income & *distributed profit*
- *Social contributions paid on own behalf*
- *Corporate income tax & any taxes on capital income*
New Information Collected & Methodology

• Collected new information on the tax treatment of non-standard work via a questionnaire sent to OECD delegates\(^1\)

• Using this information, we model, for each country:
  1. The total employment cost to a firm of employing a worker of each type that exists in that country
  2. The net take-home pay of an individual organised as a worker of each type

• The results are summarised by the **payment wedge**, a measure of the net amount that government receives as a result of taxing labour income, inclusive of social contributions
  • It is also the difference between (1) and (2), expressed as a percentage of (1)

\(^1\) The questionnaire was sent to delegates of OECD Working Party No. 2 on Tax Policy Analysis and Tax Statistics.
Example: the Netherlands

Decomposition of Total Employment Cost by Employment Type

- **EURO**
  - **Total employment cost = 64,960**
  - **Payment wedge = 51%**
  - **Labour income**
    - Take-home pay = 49%

- **EURO**
  - **Total employment cost = 40,911**
  - **Payment wedge = 22%**
  - **Labour income**
    - Take-home pay = 78%

- **EURO**
  - **Total employment cost = 53,074**
  - **Payment wedge = 40%**
  - **Labour income**
    - Take-home pay = 80%
Payment Wedge by Employment Form & across Countries
Payment Wedge by Employment Form & across Countries
Payment Wedge by Employment Form & across Countries
Indicator of Extent to Which Tax Treatment of NSW Differs
(\% Diff. between Payment Wedge of NSWers & Payment Wedge of Employee)
Conclusions

• Across the eight countries considered, the tax treatment of non-standard work differs from that of standard employment
  – Firms that contract labour from self-employed workers are not liable for social contributions on their behalves
    • While this is true in most countries, some countries (e.g., Italy, US) require the self-employed to make social contributions at higher rates
  – Others differences include rules governing tax credits, differential tax rates applied to labour versus capital income

• Rising shares of non-standard work could be partly tax-driven
  – Individuals’ choice of organizational form is known to be highly responsive to changes in effective tax rates
Policy Considerations & Next Steps

• Large tax differences between employment forms are unfair and inefficient
  – Are they justified by differences in benefits or employment rights?

• Entrepreneurial risk does not in itself justify favourable tax treatment
  – Need to define what policymakers want to support, e.g., innovation, start-ups
  – Across-the-board lower taxation of self-employed is likely poorly targeted

• Next steps
  – Extend analysis to 16 additional countries
  – Integrate analysis of benefit entitlements
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### Taxonomy of Non-standard Work

<table>
<thead>
<tr>
<th>Non-standard work: Own-account workers / self-employed</th>
<th>Unincorporated</th>
<th>Incorporated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>Contractors, sole traders</td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>Contractors, sole traders</td>
<td>Incorporated contractors</td>
</tr>
<tr>
<td>Hungary</td>
<td>Sole traders</td>
<td>Quasi-self-employed</td>
</tr>
<tr>
<td>Italy</td>
<td>Contractors, sole traders</td>
<td>Artisans or merchants</td>
</tr>
<tr>
<td>Carnegie</td>
<td>Contractors, sole traders</td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>Sole proprietorships; S corporations</td>
<td>C corporations</td>
</tr>
</tbody>
</table>

- “Other” employment forms (e.g., quasi-self-employed, continuous and coordinated workers, and workers) introduced to give vulnerable categories of self-employed workers some rights and benefits.