Response from ICAS to the HMRC consultation document

Off-payroll working in the public sector: Reform of the intermediaries legislation

18 August 2016

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About ICAS

1. The following paper has been prepared by the ICAS Tax Committee. This Committee, with its five technical sub-Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

General comments

2. ICAS welcomes the opportunity to comment on the consultation 'Off-payroll working in the public sector: reform of the intermediaries legislation' issued by HMRC on 26 May 2016.

3. ICAS[1] supports the idea of a clearer test on the existence of employment, but has concerns about reliance on an on-line tool on the basis outlined. It has been difficult to obtain certainty, based on the nuances of case law, and its seems unlikely that an on-line tool could achieve clarity without significant simplification of the underlying rules.

4. The transfer of decision making, and responsibility for applying intermediaries rules to hirers, particularly where the hirer assumes responsibility for employer's National Insurance contributions, is potentially a step forwards. However, the inclusion of agencies as decision makers is problematic.

The effect of further change

5. Recent HMRC research [2]suggests that businesses are not always aware of Intermediary rules and that additional rules may potentially impact business decisions and flexibility of labour.

6. Piecemeal change is potentially unhelpful: adding to uncertainty. The impact on Personal Service Companies (PSCs) of recent changes to dividend taxation has yet to be assessed. Certainty and stability would be welcome.

Status

7. We recognise Government concerns about reduced tax and National Insurance yield caused by the use of Personal Service Companies (PSC) in the public sector. The impact on working practices on PSC workers should also be considered.

8. The bargaining position of many workers is limited and using a PSC, or other intermediary, may be a requirement of the engager, or imposed though industry expectations.

9. Tax revenues could be protected and worker's rights safeguarded by requiring hiring firms to take on PSC workers as direct employees, if the status tests indicate that the arrangement should be one of employment.

10. It should be noted, that in some cases the tax liability may now be higher for the PSC route than for direct employment.

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[1] Response from ICAS to the HMRC discussion document Intermediaries Legislation (IR35) 29 September 2015
https://www.icas.com/__data/assets/pdf_file/0006/246723/20150929-Submission-Intermediaries-Legislation-IR35.pdf

[2] HMRC Research report - Intermediaries Legislation Qualitative Research; July 2016
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/530151/Intermediaries_Legislation_Qualitative_Research_-_July_2016.pdf

11. PSC workers to whom IR35 rules apply are being taxed as employees, though without the employment rights that would usually accrue.

12. Consideration should be given to a re-evaluation of the purpose and impact of the IR35 regime. For workers to be taxed as employees, but without acquisition of employment rights is unsatisfactory.

Specific questions

13. As the Intermediaries legislation has already been the subject of a number of consultation documents, we focus here primarily on operational issues relating to the proposals.

Question 1: **Are there other easily understood definitions that work better than the FOI Act and the FOI (Scotland) Act?**

14. While it would initially seem attractive to use pre-existing definitions, there are a number of complex areas within the Freedom of Information legislation. For example, a company wholly owned by one local authority is subject to the Act, but a company owned by more than one local authority is not. Similarly the rules apply to wholly owned companies, not to partly owned companies.

15. The definition of Public Authorities, as given in Schedule 1 of Freedom of Information Act 2000, and Schedule 1 of Freedom of Information (Scotland) Act 2002 are subject to change.

16. As the freedom of information rules were not drawn up with tax issues in mind, it may be that a more straightforward tax-sensitive definition can be achieved. This would avoid the situation where minor changes in ownership could potentially take an organisation outwith the rules.

Question 2: Are there any public sector bodies which are not covered by the FOI acts which should be included in the definition for the proposed rules?

17. As the policy intention here is that arrangements which are essentially similar should be taxed in the same way, care is needed to include corporate bodies which are in effect carrying out a 'public authority' role, where minor differences in ownership mean that they fall outside the strict Freedom of Information Act definition of a public body.

Question 3: Should private companies carrying out public functions for the state be included in this definition? Why?

18. See our general comments above in which we note that difficulties and inadvertent avoidance opportunities can be brought into legislation when new boundaries are brought in. Clearly, one way around these rules would be to use a private company and this might become a factor in influencing behaviours.

Question 4: Are there any public bodies caught by this definition who would face particular impacts which should be considered?

19. We do not have information on this point.

Question 5: Are rules needed to ensure that engagers have the information they need to make the decision? If so, what should they be?

20. Rules are unlikely to be sufficient to enable engagers to have sufficient information available at the right time. What is important is who the decision-maker is, and that the decision-maker bears responsibility for application of the rules.

21. The current proposals are simplistic in expecting that there will be sufficient information available from inception, particularly to a third party agency, to determine employment status.

22. Exact work relationships are unlikely to be determined until the contact is being performed. It is possible that the nature of the relationship will vary over time. On-going monitoring of contracts would be a very significant administrative and logistical burden, but it may be appropriate to have fixed-term reviews (for example, an initial decision could apply for, say six months, and would not be subject to challenge unless it was wholly unreasonable). Consideration should be given to exempting short one-off contracts from the rules.

23. Responsibility should be placed on the hirer, rather than the agency, as agencies are not best placed to evaluate on-the-ground arrangements between worker and hirer. The agency nearest to the worker may even be at some remove from the hirer, making information flow impracticable.

Question 6: How would accounting for the 5% allowance work in practice?

24. Employers are used to making deductions from gross pay, before applying tax and NIC. It would not seem insuperable for the 5% deduction to be included as a deduction from gross pay. This could then be repaid to worker via the purchase ledger (as VAT will be paid) or via the payroll as an addition to post-tax income.

25. It is likely to increase complexity for the hirer, along with associated administrative costs. Complexity makes errors more likely.

Question 7: Are there business costs specific to PSCs that are covered by the 5% that aren't covered under the usual business expense rules?

26. No such items have been brought to our attention.

Question 8: Does the first part of the test work to quickly rule out engagements that are clearly out of scope?

27. See our general comments: we have concerns about reducing nuanced tests to a series of yes/no questions. Subject to this, we have the following comments on the specifics.

28. The rule here “Is 20% or more of the contract for materials consumed in the service?” is arbitrary. IR35 is supposed to apply to relationships which, apart from the intermediary, would be ones of employment. Indicators of self-employment are much wider than simply the supply of materials. Use of an arbitrary percentage for materials could distort the market.

29. The first set of tests, therefore, appears to extend the scope of the IR35 rules.

30. The second set of tests focus on substitution and control. The control question appears very wide. Some control over ‘how the work is to be done’ is likely to be universal. The test should focus on whether the work is ‘micro-managed’ by the hirer: setting the boundary as that between a supervised employee and an expert, or time-served journeyman, who is competent to supervise their own work, without detailed day to day management from the hirer.

31. The question ‘does the worker own their own company?’ demonstrates the practical difficulties here. A family company might have a worker director who owns 45% of the share capital: prima facie such a director could answer ‘no’ to the question.

Question 9: Are these the right questions in the right order of priority?

32. The order of priority may be reasonable, but the scope of the questions is very limited.

33. It is difficult to reduce often complex weighting of factors to a set of simple questions, and still obtain a reliable answer. IR 35 rules potentially cover disparate groups of workers.

34. Consideration should be given to having industry-specific tests, even if this is in very broad terms. A supply of materials test may be relevant in the Construction Industry test, but is not applicable to other sectors such as IT / service industry / professional workers.

35. There should be a right of appeal, by the worker, to any determination made by an online tool.

Question 10: Are the questions simple to understand and use?

36. Substitution and control are not simple concepts. This is partly because there is a difference between the rights of supervision and control and what actually happens on the job. A requirement to re-visit these questions after the contract has been in force, for say a couple of months, would be more likely to obtain a clear answer; but this could also increase operational costs.

37. A percentage material test is objective and clear, but is open to manipulation.

Question 11: Do the two parts of the test give engagers certainty on day one of the hire?

38. No. It is unlikely that the exact nature of the working relationship will be known at this stage.

39. Specific issues: Substitution / personal service clauses: “is the worker required to do the work themselves?” – actual substitution may only become apparent over time.

40. Control: as noted under Q5 above, the exact nature of the control exercised is unlikely to be clear ab initio.

41. Lack of certainty over tax treatment has business implications as workers will face the risk that contracts will be reclassified, with a resultant higher tax cost, after basic payment terms have been agreed. This could affect the behaviour of workers, making public sector contracts less attractive.

Question 12: How can the organisation completing the tests ensure they have the information to answer the questions?

42. Agencies, and other intermediaries may have access to the written contract, but it will be difficult for anyone but the hirer and the worker to be fully aware of all the information needed to make the decision.

43. Could the online test be provisionally completed by the worker, with the results forwarded to the agency/hirer for review?

44. There is a danger that agencies and hirers will ‘err on the cautious side’ and treat some freelance workers as subject to the rules, to reduce their own potential exposure to financial penalties.

Question 13: How could the new online tool be designed to be simple and straightforward to use?

45. The hierarchy of questions is likely to be simpler if there are parallel routes for different industries. This will avoid the potentially confusing issue of dealing with questions which do not appear to be relevant for the specific job under consideration.

46. In general, it seems unlikely that an online tool will give certainly and accuracy in all cases. Consideration should be given to online decisions being binding - favouring

certainly over accuracy - within certain financial limits; with an appeal route for complex cases.

Question 14: Where should the liability for tax and National Insurance (and penalties and interest where appropriate) fall when the rules haven't been applied correctly?

47. The liability should normally fall on the hirer. Where a decision is disputed, consideration should be given to how the decision came to be made.

Question 15: Should the liability move to the PSC where the PSC has given false information to the engager?

48. The test here needs to be at the standard of fraud / deliberate error. It is all too easy for differences of opinion to exist about the information supplied.

49. The actual performance may differ from contract and this may only become apparent during the life of the contract. This increases the risk that an initial decision is, with hindsight, considered inappropriate; even though it may have been reasonable.

50. The worker is not always in a position to determine the contractual terms due to differences in the bargaining power of the parties; this should be taken into account when evaluating liability.

51. Significant safeguards are needed before any transfer of liability occurs, including proof of deliberate delivery of false information with intention to evade a tax liability.

52. From a practical point of view, how likely is it that the recovery will be effective in such circumstances?

Question 16: What one-off and ongoing costs and burdens do you anticipate will arise as a result of this reform?

53. There would be a considerable ongoing burden of administration if changes to working arrangements need to be monitored over the life of the contract. Contractors in the public sector may face loss of income.

54. There are likely to be increased initial administration costs, systems changes for engagers, staff training and computing costs. PSCs and professional firms will face two parallel sets of rules, one for public sector and one for private sector contracts. This is likely to increase costs.