Low Incomes
Tax Reform
Group

A voice for the unrepresented

Travel expenses for the low-paid
– *time for a rethink?*

A research report by the
Low Incomes Tax Reform Group of
The Chartered Institute of Taxation

November 2014

A large print version of this report is available from The Chartered Institute of Taxation upon request. Please write to the Low Incomes Tax Reform Group, The Chartered Institute of Taxation,1st Floor, Artillery House, 11-19 Artillery Row, London, SW1P 1RT.

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Foreword

The purpose of this report is to shine a light on the use of a particular umbrella arrangement by low-paid agency workers to obtain relief for their travel costs – declared 'non-compliant' by HM Revenue & Customs (HMRC), but still, evidently, widely in operation.

We keep hearing from the Government how such 'flexible' workers are a vital part of the economy, but they often earn little more than the National Minimum Wage (NMW) (which at the time of publication is £6.50 per hour), they frequently have to change sites to stay in work and the unavoidable costs of getting to their assignment locations to perform their duties can take up a disproportionate amount of their wages.

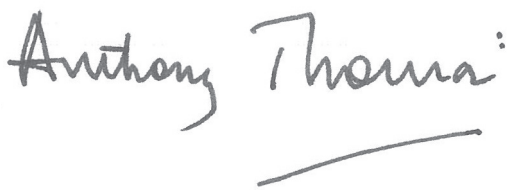
Yet, whilst the travel expense rules as they stand recognise the 'extra' costs of an international assignee on secondment to a 'temporary workplace' in the UK (and thus permit him to claim tax relief on a wide range of costs including rent, utility bills and food for up to 24 months) they deny any travel expense relief to, often, low-paid 'temps'.

In light of this unfairness, it is hardly surprising that the 'umbrella' concept took hold, sweeping through every aspect of the UK's 'temporary' workforce – essentially providing a framework within which an agency worker's successive work locations could be turned into 'temporary workplaces' for the purposes of meeting the law in question. However, since the arrival of a particular umbrella model called 'Pay Day by Pay Day' (PDPD) and the confusion and uncertainty that accompanies it, the financial positions of some those using the arrangements have become worse than they ever were.

We hope to have set out clearly and concisely in this report that the current situation is unsatisfactory and that this, in part, is down to the shortcomings of the authorities in dealing with the PDPD phenomenon at employer level. Of course we recognise the role of the various enterprises who are exploiting the gap in the market, but to some extent their behaviour is to be expected in a competitive, unregulated environment so there has to be some joint responsibility here.

This has been a bit of a saga from the outset and we trust that this report will not only provide the impetus for a period of reflection and a change of tack on this particular issue but will also inform HMRC and other government departments in their dealings with the perennial 'problem' of travel expense relief for the low-paid agency worker in the future.

Signed



Anthony Thomas
Chairman, Low Incomes Tax Reform Group

1. Executive summary

- A combination of work insecurity along with often poor pay and disproportionate travel costs means that agency workers can face uniquely tough times. Further, despite them having a 'temporary workplace' in the ordinary, natural meaning of the word 'temporary' and having little ability to plan around the fixed commuting costs of those in a permanent employment, there is no recognition of their expenses in the UK tax system.

- Umbrella companies provide a framework within which an agency worker's successive work locations can be turned into 'temporary workplaces' for the purposes of securing them some 'relief' under our outdated travel expense rules.

- Such arrangements are controversial – to some they are not within the spirit of the law but to others they provide nothing more than a 'straightforward' tax advantage – a bit like Personal Service Companies for example. This may explain why we have seen inconsistent and sometimes contradictory messages being sent out by policymakers on the desirability of such schemes.

- Nevertheless, they have been allowed to subsist although this has been accompanied by a seeming reluctance by HMRC to engage with responsible umbrella companies in reaching consensus on a compliant model – we think this may well have contributed to there being a vast spectrum of operators in the market place.

- Worried about the effect of some of the more cavalier operators on agency workers, in 2011, NMW legislation was introduced that essentially put an end to umbrella schemes as a means of engaging the labour of the low-paid. This saw many employees' take home pay fall overnight, despite the fact that at least half of the consultation responses on the matter had called for the impact to be assessed in more detail before proceeding.

- Further, the resulting NMW legislative amendment was not wholly effective ('imperfect' as one judge described it) and in an industry full of creative thinkers, other schemes were created to exploit this – including one based on traditional umbrella arrangements called 'Pay Day by Pay Day' (PDPD). This claims to meet the new NMW rules but still help workers make savings, with tax and National Insurance contributions (NIC) being applied to the workers' net (after-expenses) income. This essentially results in unreimbursed travel expense relief being administered at source by the employer, supposedly assessed by reference to the employee's actual expenses each pay period – hence the name 'Pay Day by Pay Day'.

- The scheme providers say that this relief-at-source mechanism is technically underpinned by the tax and social security legislation, and has been backed by QC opinion. However, in accordance with the more generally accepted interpretation of the law, these schemes fail to properly account for the correct tax or employee and employer NIC.

- Despite HMRC taking the unusual step of publishing two statements warning that the relief-at-source mechanism was 'non-compliant' (and also a subsequent court case involving the Gangmasters Licensing Authority – the outcome of which was consistent with HMRC's position) it can hardly be said that the authorities have shown any assertiveness in tackling the schemes. Certain advocates of the scheme are unfazed in any case – convinced that the arrangements are permitted.

- Ultimately it seems that this will be a matter for the courts to decide. However, whatever the outcome, a further dimension to be considered is that increasing numbers of people in the tax profession and more widely, consider that the law underpinning unreimbursed expenses (as it is more generally accepted at the moment) is flawed and needs to be looked at in any case – as recent work by the Office of Tax Simplification (OTS) calling for changes in this area testifies.

- It is hard to deny that a sensibly run PDPD scheme can (on the face of it) have some relatively useful features from the perspective of the low-paid agency worker in terms of helping to overcome some of those flaws. PDPD has therefore perhaps put HMRC in a difficult position – forcing them to confront the two difficult and complex concepts of umbrella arrangements and the treatment of unreimbursed expenses at the same time. This may explain why it seems to have been some time since PDPD providers were put under any real scrutiny by HMRC.

- Both of these issues look set to be debated in detail as part of the recently announced Travel and Subsistence review – however, by the authorities' own admission, this is going to be a 'slow burner'. Meanwhile the uncertainty over the 'legality' of the scheme makes its use somewhat risky, but there are many reasons why workers use them – sometimes they are unaware of the problems with them (or even how they operate even on a basic level), other times it is because they feel no choice but to use them.

- In the void that exists, PDPD is still being widely marketed and utilised by agency workers at or near the NMW. Yet involvement in such a scheme can see the workers being pursued later for underpaid tax by HMRC. On one view, this is unacceptable and HMRC ought instead to suppress this activity at its source. If HMRC consider that the schemes are non-compliant then they, as the department tasked with the responsibility of 'collection and management' of the UK tax system, should seek underpayments of Pay As You Earn (PAYE) at the source of the problem. The data in their various new sophisticated systems (such as Real Time Information (RTI)) means it should be quick and easy for their employer compliance function to identify the PDPD employers.

- Further, they should then build a case against a PDPD provider, so that the various arguments for and against the model can be tested once and for all – certainty, after all, is one of the cornerstones of a good tax system.

- In the mid to long term we recognise that a clampdown on PDPD (if indeed this is what the authorities intend) may only make things more messy as new schemes will come to market. As such, and with an eye on what is just and reasonable for the worker, we think it would save considerable effort all round if the authorities were to address the underlying anomalies in the framework that drive the need for agency workers to use such arrangements in the first place, rather than undertake yet further tinkering around the edges where complexities will flourish.

- Put simply, we think that there needs to be a 'fix' of the base rules that currently serve to work against low paid agency workers. Now that some of the issues around travel and subsistence have been aired in this report, we hope that there can be an informed debate as to what this 'fix' should look like.

2. About the Low Incomes Tax Reform Group

The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 the LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

The LITRG works extensively with HMRC and other Government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3. Introduction – background and scope of this report

Background

The model of full-time work with one employer for a person's entire working life is becoming almost unheard of. People move jobs, flex their hours and may even change careers out of necessity or choice. Particularly at the low-income end of the scale, 'jobs for life' are likely to be non-existent and even finding full time or permanent work can be a challenge.

Against the backdrop of the Government policy 'making the labour market more flexible, efficient and fair'[1], employment in temporary agency work (or 'temping' as we might otherwise know it) represents a vital part of the UK's economy. Indeed, via the Work Programme[2], the Government commissions private employment businesses to assist with the integration of unemployed people into jobs, via temporary work[3].

There are over 1.67 million temporary workers (temps) in the UK, making up around 6.5% of the workforce and this figure seems to be steadily rising[4]. They are a popular choice for employers, for example because they allow businesses to respond quickly to changes in labour supply or surges in demand. It is unsurprising then, that recruitment industry turnover reached a peak £26.5 billion in 2012/13 and is set for year on year growth[5].

Agency workers

Many temporary workers obtain their posts via agencies. However, this is not always the case, with some employers seeking to hire temporary workers direct and creating their own 'bank' of individuals to call upon according to the peaks and troughs of their business. This report is focusing mainly on agency workers.

It is not possible to give a description of a 'typical' agency worker, but from our various researches in the course of preparing this report, we have drawn the following broad conclusions:

- They tend to have jobs requiring low to medium skills that are low paid (at or around the NMW, and sometimes even below NMW if their employers are not following the Regulations). These might include administrators, cleaners, hospitality staff, care workers, factory workers, plant and machinery operatives and other lower-paid occupations.

- Often they are less well paid than their directly-hired counterparts.

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1 See https://www.gov.uk/Government/policies/making-the-labour-market-more-flexible-efficient-and-fair

2 See https://www.gov.uk/Government/policies/helping-people-to-find-and-stay-in-work/supporting-pages/managing-the-work-programme

3 For example: http://www.staffline.co.uk/candidates/welfare-to-work/

4 Source: Office for National Statistics Labour Market Survey 16 July 2014, page 54, latest figures are for March to May 2014 – see http://www.ons.gov.uk/ons/dcp171778_367199.pdf

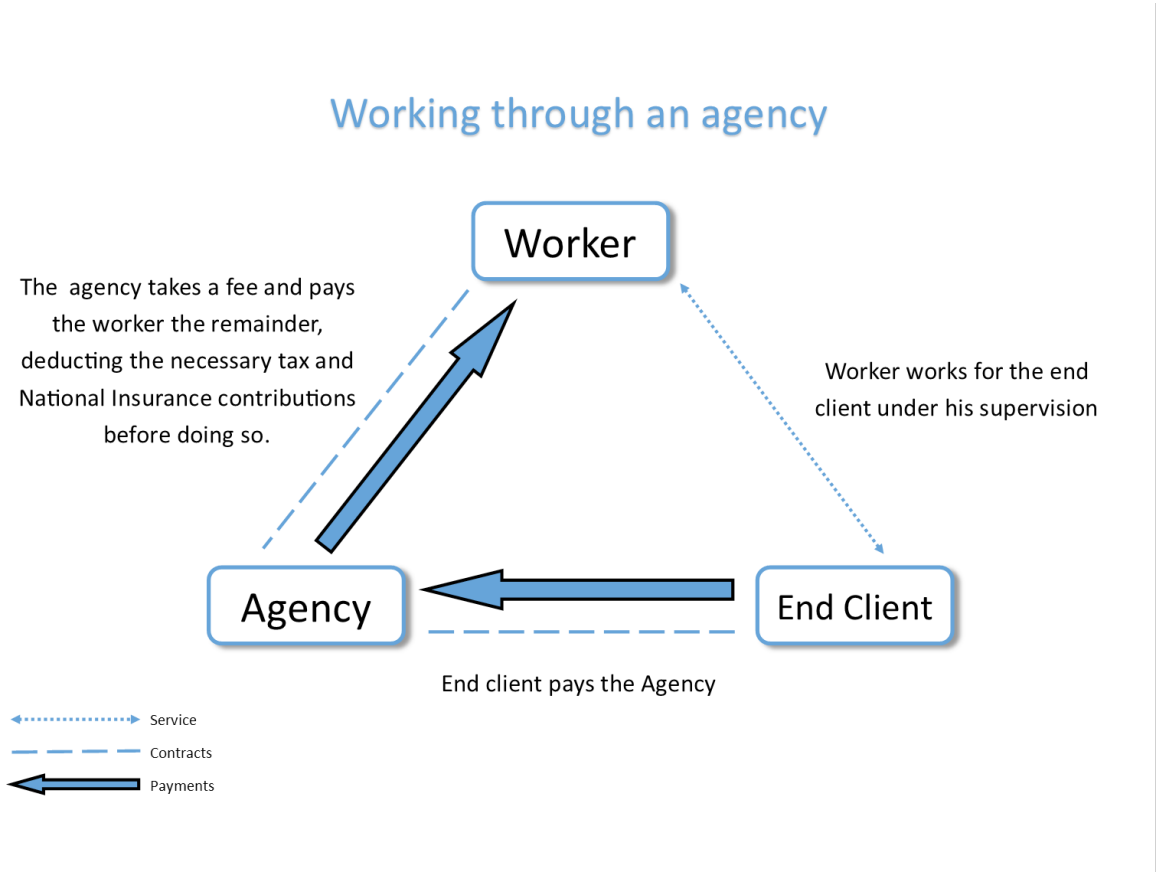
5 According to the Recruitment and Employment Confederation (REC's) latest annual Recruitment Industry Trends Survey, published November 2013, £24.1 billion (91%) of the market value is from 'temping' business with the remainder from permanent recruitment activity (i.e. introduction agencies). See report press release: https://www.rec.uk.com/news-and-policy/press-releases/uk-recruitment-market-set-to-surpass-pre-recession-peak-by-the-end-of-201314-rec

- They are predominantly from younger age groups, although there is no real gender bias.
- Minority ethnic groups tend to be over-represented in terms of agency working.
- Educational attainment varies, but there is a correlation between low educational achievement and those in lower-paid temporary and agency work.
- Agency workers (and indeed temporary workers more generally) may be at higher risk of occupational accidents and tend to have less access to training.

There is no doubt that to some people, temporary work (either directly or via an agency) is desirable as it may give them the flexibility they require for their lifestyle, for example to fit in with childcare. However, for the majority, temping will not be a matter of choice; rather, it will be something they are forced to turn to if they have not been successful in finding a permanent job or alternatively if they wish to gain experience and employability.

Protection for agency workers

Traditionally, agency work has involved a triangular arrangement in which an agency (technically known as an employment business) supplies workers to 'end clients' and remains part of the ongoing relationship between the worker and the end client.



The worker will usually perform tasks under the day-to-day supervision of someone at the assignment location but will send time sheets to the work agency that pays them. This makes the worker's employment status rather complex as technically, the temp is usually neither an employee of the end client nor of the agency. Typically they are 'workers' for employment law purposes (the category that sits somewhere between employees and the self-employed) and as such are entitled to basic protections, such as being paid at least the NMW and working time

entitlements such as paid annual leave[1].

The Agency Workers Regulations[2] (AWR) were meant to strengthen a worker's position by conferring the same basic terms and conditions as a directly-hired worker on the agency worker after 12 weeks in the same job. We understand that unfortunately, these Regulations may not have provided the envisaged protection – as there are ways around them[3]. However, further discussion of these Regulations lies outside of the boundaries of this report.

Agencies themselves are not highly regulated in the UK. However, there is the Gangmasters Licensing Authority (GLA), a non-departmental public body, set up after the Morecambe Bay cockle picking tragedy. Since 2006, the Gangmasters Licensing scheme sets out requirements for businesses supplying labour into the agricultural, horticultural, shellfish-gathering and associated processing and packing industries. Its three key priorities are: preventing worker exploitation; protecting vulnerable people; and tackling unlicensed and criminal activity. Many workers in the GLA sector are paid at or around the NMW.

In summary, life for low-income agency workers can be precarious and insecure, with no guarantee of work. In addition, a worker's tax and NIC position can also be uncertain and complex.

Tax and NIC

Despite the worker not being an employee of the agency, generally the agency is responsible for deducting income tax and employee (primary) NIC from the salary paid to the worker. They must also pay employer (secondary) NIC. This treatment is applied by legislation[4] which deems such payments to be employment income.

Ways of side-stepping this legislation have been developed over time, leading to the recent consultations on tackling 'offshore intermediaries'[5] and 'false self-employment' in agency worker arrangements[6]. We mention such arrangements again briefly later on, but for the main part of this report we focus on the operation of travel and subsistence schemes for agency workers via the use of 'umbrella companies' – which also result in the removal of the PAYE obligation for the agency.

Travel Expenses

Travel expenses are tax deductible where they are necessarily incurred in travelling in the performance of the duties of the employment or for 'necessary attendance' at any place in the performance of duties of the employment which are not ordinary commuting or private travel[7]. Therefore the costs of travelling to one's permanent workplace are not allowable but the costs of travelling on business, either direct from home or from the permanent workplace, are allowable. So if, for example, a worker travels direct from home to a client's premises for a meeting, the full expense of getting there is allowable. But if the worker goes to the office first, then travels to client premises, only the element from the office to the premises is allowable.

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1 https://www.gov.uk/agency-workers-your-rights/overview

2 AWR came into force on 1 October 2011.

3 See http://www.acas.org.uk/index.aspx?articleid=4162

4 For income tax, sections 44 to 47 of the Income Tax (Earnings and Pensions) Act 2003 apply. For National Insurance purposes, a person working through an agency is to be treated as an employed earner for Class 1 NIC purposes. The Social Security (Categorisation of Earners) Regulations 1978 also provide for the agency to be treated as the secondary contributor.

5 See LITRG's response here http://www.litrg.org.uk/submissions/2013/130808_LITRG_offshore_empl_inter

6 See LITRG's response here http://www.litrg.org.uk/News/2014/140204_offshore_emp_inter_false_SE_LITRG

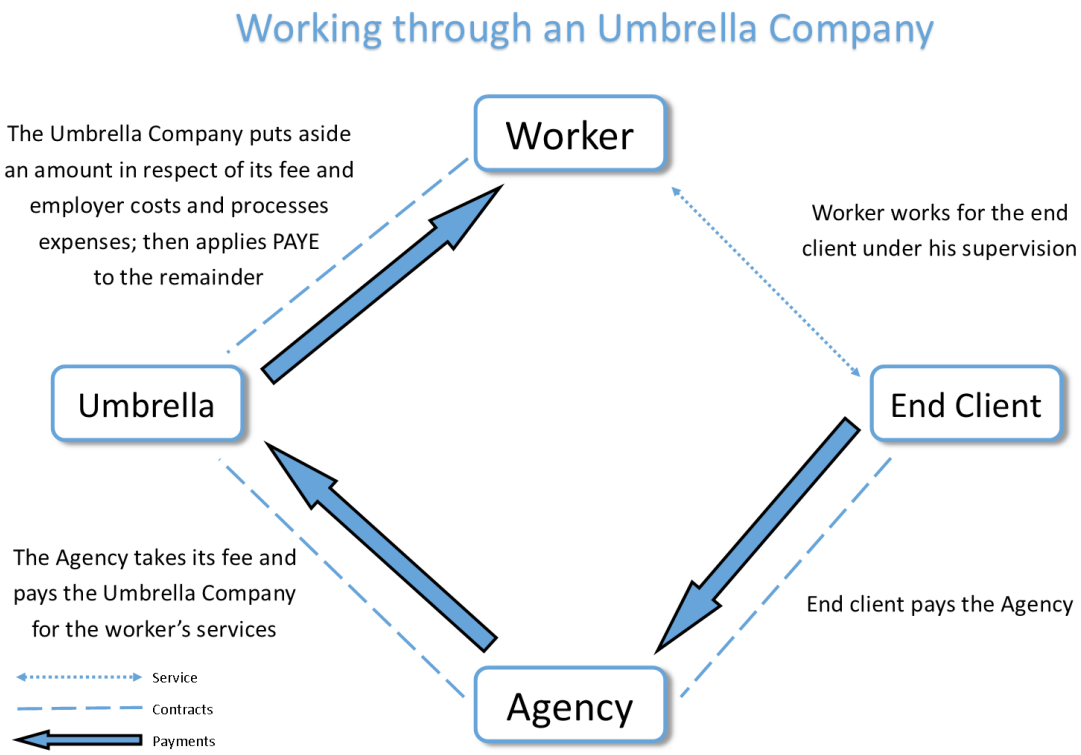
7 Sections 337 – 340 Income Tax (Earnings and Pensions) Act 2003 (with further rules relating to overseas employment and performance of duties abroad in sections 341 and 342).

In addition, if a worker is sent temporarily from his normal workplace to a different workplace for up to 24 months, returning to his normal workplace thereafter, he is allowed tax relief for the related travelling, accommodation and subsistence expenses (the 'temporary workplace' rules), as are site-based employees (employees without any fixed workplace whatsoever).

Although agency workers may be contracted to work on different engagements through the same employment agency, each engagement is treated as a separate employment for tax purposes. A temporary worker would normally attend only one workplace for all or almost all of an engagement, therefore where there is only one workplace per agency placement, that workplace will be a permanent workplace for that employment. This means that agency workers are not entitled to tax relief on the travel and subsistence expenses they have incurred.[1]

The rise of the Umbrella

We referred above to the triangular arrangements of agency worker, agency and end client. But in recent years, a fourth entity has become involved in the chain – the 'umbrella' company. These sit between an agency and worker, as illustrated below.



Umbrella companies were essentially born after the introduction of 'IR35' and the subsequent Managed Service Companies legislation. These were 'anti avoidance' measures, designed to counter arrangements that had been put in place to shelter from PAYE (usually via an intermediary company) what might otherwise have been regarded as taxable employment income. We look at how umbrella companies became part of the tax system landscape in more detail in Appendix 1.

1 EIM32130 – 'Where a worker provides his or her services through an agency and the agency legislation in Section 44 ITEPA 2003 applies, each agency contract is treated as a separate employment…. Therefore, where there is only one workplace for an agency contract that workplace will be a permanent workplace for that employment. The agency employment is dealt with as a fixed term appointment.'

Although the umbrella structure started life by offering a possible escape route from the above anti avoidance measures to highly skilled, independent contractors working in industries such as information technology, engineering and construction, it opened out into other sectors with large numbers of transient workers who use employment businesses to find temporary jobs.

We attempt to summarise simply below how traditional umbrella companies work:

- Umbrella companies are employers. Their sole purpose is to employ staff (often called 'contractors' or 'freelancers'). They take on workers as their own employees with continuous contracts of employment.

- These workers then provide their services to end clients. However the umbrella company does not source the engagements. In most cases an agency (employment business) will source engagements.

- Having a 'core' employment with the umbrella company means that the various end user client sites turn into ***temporary workplaces*** and means the ***expenses*** of travel to those workplaces from home (amongst others) are allowable against tax.

- Such a state of affairs is often backed up by the business having obtained a ***dispensation*** from HMRC so that it can pay the worker's travel and subsistence expenses without having to report them to HMRC.

- Rarely will the expenses be paid over and above the worker's pay, instead they will enter into a ***salary sacrifice*** scheme and agree that an amount of pay, which would otherwise be subject to tax and NICs, is replaced with tax and NIC free expenses payments.

The terms continuous contract of employment, temporary workplace, expenses, dispensation and salary sacrifice are explored in more detail in Appendix 2.

Umbrella arrangements brought to life

We need to examine the tax and NIC advantages that using a traditional umbrella company can bring to an agency worker in order to understand why people are attracted to them. We do this by way of a made up example, below.

Example: Toby Test

- Toby Test finds a month's work through a temping agency (Agency Ltd). The work is an hour's drive away – he anticipates he will use at least a tank of petrol a week.

- The agency say to Toby that he can work through them or he can work through an umbrella company. If Toby works through the agency he will not be entitled to any relief on his costs of travel; but if he works through an umbrella company, he will. Toby chooses the umbrella company. (Sometimes the agency will provide the worker with an overarching contract of employment and operate the umbrella arrangements themselves, but we do not consider this possibility any further here.)

- Where the agency is paying a corporate entity rather than an individual, there is no requirement to deduct the worker's income tax and NICs, or to pay employers' NICs on the worker's fee.

- Toby's umbrella company will have a business-to-business contract with the agency. The end client pays the agency, say, £11 per hour for Toby Test. The agency deducts its fee for matching Toby with the end user client and will pass the rest on to the umbrella company. The rate negotiated with the agency is often referred to as the 'limited company rate' – in this instance we will call it, say, £10 an hour. It is important to note that if Toby was being paid directly by the agency, they would have offered him less than £10 per hour

as they would be footing all employer-related costs including holiday pay and employers' NIC.

- In his first week, Toby works 40 hours, so the umbrella company invoices the agency £400. Upon receipt of the funds from the agency, the umbrella company puts aside some amounts in respect of employers' NIC, holiday pay, along with its own fee, and then processes the remainder through PAYE for Toby.

- Toby receives the remainder salary – typically paid in a combination of cash and reimbursed 'tax and NIC free' temporary workplace travel expenses. Usually umbrella companies supply their contractors with two documents – a payslip and a contractor statement. We reproduce below what Toby Test might expect to get.

Umbrella Company Ltd **Tax Period: 36 (Week ending 10 October 2014)**

Employee No:	Employee Name	Process Date	Ni Number
12345	Toby Test	13-Oct-14	QQ123456A

Contractor statement

Agency receipts (2)	Units	Rate	Amount	Company Deductions	Amount
Normal time	40	£10	£400	Salary Sacrifice	£74.20
Re: Services to Agency Ltd (1)				Holiday Pay (3)	£31.38
				Employer NIC (4)	£14.90
				Margin (5)	£18.50

Payslip

Employee Payments	Units	Rate	Amount	Employee Deductions	
Salary (3)	40	6.50	£260.00	Tax (7)	£13.80
Expenses (6)			£74.20	Employee NIC (7)	£12.96
Bonus (3)			£1.02		£26.76
Total Gross Pay for Tax			£261.02	Net Pay	**£308.46**
Tax Code			1000L	Payment method	BACS

1) Umbrella Company Ltd is the name of the employer and Agency Ltd is the name of the employment agency that Toby works through.

2) Agency receipts are the details of hours and rates paid by the Agency for services supplied by Toby Test on behalf of Umbrella Company Ltd.

3) 12.07% of the workers' pay is attributed to holiday pay. Note that the worker's cash salary is made up of two parts. A guaranteed NMW payment and a 'profit related bonus'. Umbrella company contractors must ultimately fund their own holiday pay from their gross fee income, so this pay structure allows the umbrella to base holiday deductions on the NMW not the higher amount. It will be paid out at £6.50 per hour when the time is taken.

4) The umbrella company has to pay the employer's NIC. Unlike a regular employer, the umbrella company has no other income apart from the gross fee income of its contractor clients. Technically Toby Test is not paying the employer's NIC – it is deducted and paid from the Agency income that the umbrella receives for supplying his services and does not form part of his pay.

5) Very simply, there is a saving of tax and NIC as a result of the involvement of the umbrella company, therefore it takes a cut of the saving as its fee. This is usually anything up to around £25 per week.

6) Toby's expenses comprise a mileage claim for 30 miles a day and a small amount in respect of a coffee and a

sandwich he bought from the canteen when he forgot his packed lunch. An amount equal to the relievable expenses has been reduced from taxable pay by way of salary sacrifice, and then added back. They are not subject to tax or NIC.

7) Total gross pay typically includes salary, commission and holiday pay (if any). Income tax and the contractor's employee NICs are calculated based on the total of all these amounts, less expenses – in Toby's case £261.02.

Toby Test's overall take home pay is therefore made up of salary, bonus and tax and NIC free expenses equalling £335.22, less tax and NIC of £26.76. The alternative for Toby would have been to be paid by the agency in accordance with the 'agency rate'. If we assume this works out to give him the same overall 'gross' of £335.22[1], but with the inability to swap some of his salary for expenses, then his overall take home pay would have been made up of salary and bonus only, with tax and NIC of £50.50[2] – leaving net pay of £284.72.

By using the umbrella company, Toby is £23.74 better off that week as his net pay is £308.46. Relative to Toby's circumstances this represents a significant uplift. The £23.74 saving is made up of the tax relief of £14.84 that is conferred by them providing him with an overarching employment contract plus the NIC benefit from the salary sacrifice mechanism. It is important to note that tax relief would be available to Toby whether he sacrificed salary or not (provided he has an overarching contract). If he did not sacrifice salary, then tax relief would be available to Toby – he would just have to make a claim to HMRC for a refund at the end of the year. However because of the seeming non-alignment of underlying tax and NIC rules, for NIC, no such end of year reclaim is possible. Toby can only receive NIC relief where the expenses are reimbursed by his employer. As such, by giving up £74.20 in cash, and receiving £74.20 in expenses under the salary sacrifice facility, he is saving an additional 12% NIC, that is £8.90.

Vast spectrum of providers

The barriers to enter into the 'umbrella' industry are low – it is relatively easy to set up an umbrella without a significant capital outlay.

There is a wide spectrum of operators. Some umbrella companies evidently take compliance and the welfare of their employees very seriously, however others seem to have a rather more laid back approach to both, leading to arrangements that are problematic for both the Exchequer and the worker. In the absence of any statutory regulation of the sector, there is some attempt to self-regulate so that workers are not exploited and can understand their position when being taken on by an umbrella company.[3]

Problems that might arise include:

- the overarching contract of employment being ineffective[4];
- umbrella contracts being offered in inappropriate circumstances, for example where the worker does not intend to take multiple assignments or where it is a 'temporary to permanent' position. Both of these things mean that the employer and employees will have received tax/NIC relief on travel expenses that was not due and will have paid less tax and NIC than they should have done.

1 In reality, we are aware that reaching the 'limited company rate' and the 'agency rate' for any given worker is likely to involve a much more complex set of calculations using sophisticated travel and subsistence software.

2 Tax: £335.22- £192 (personal allowance) x 20% = £28.64. NIC: £335.22- £153 (primary threshold) x 12% = £21.86

3 See for example All Umbrella Companies Are Equal – http://www.allumbrellacompaniesareequal.com/

4 Contracts purporting to be overarching may not be, where for example, they offer no guaranteed work or calculate holiday entitlement on an assignment by assignment basis – more detail is given in Appendix 2 to this report.

However, most problems occur when the rules on travel expenses and dispensations are abused, such as in the case of Mrs A set out below:

Real life case study – Mrs A

> Mrs A is a locum nurse. She found work through a medical staffing agency, who recommended that she use an umbrella company.
>
> During the time she was working with them, she earned about £13,000. However, when she received her P45 it showed £3,646.17 taxable pay with £422 of tax. This meant that the umbrella company had claimed relief on the vast majority of her earnings – attributing them to reimbursed tax and NIC free 'expenses'.
>
> One payslip we have seen showed cash earnings of £228 and reimbursed expenses of £653.46. Unless it can be shown that Mrs A actually incurred expenses equal to that amount, and that those expenses were properly allowable against tax, this is open to challenge on the basis that the 'expenses' element is, in reality and in law, ordinary earnings and taxable as such.
>
> Mrs A could easily find herself being pursued by HMRC. In addition, because allowable expenses in the income calculation for tax credits purposes generally follow the income tax rules, Mrs A may have declared her income on her tax credits claim as £3,646.17. If the expense amount is later found to be taxable earnings, the tax credits award will turn out to be too high, resulting in recoverable overpayments and possibly a penalty.

We assume that it was concern around situations like this that led to Government focusing attention on umbrella companies in 2008. We look at this, and what followed thereafter, in the next chapter.

Scope

This report looks at how concerns about the use of what we shall call 'traditional' umbrella arrangements in 2008 moved on and resulted in the birth of a variant thereof in 2011, commonly referred to as 'Pay Day by Pay Day' (PDPD).

We then look at the workings of the PDPD umbrella model.

HMRC's view is that 'the model….does not comply with the Taxes Acts or Social Security Acts and associated Regulations'[1] – yet many schemes are still being widely marketed and we explore HMRC's approach to tackling them.

By using the scheme, the worker's take home pay is increased. In light of financial pressures on the low-paid, workers are unsurprisingly drawn to them, often completely unaware that they could be storing up trouble for themselves in the form of a P800 underpayment calculation. We consider other factors as to why low-paid workers might have little or no choice in signing up to an umbrella arrangement, including looking at Department of Work and Pension's (DWP) Guidance used by Jobcentre Plus decision makers dealing with Jobseekers Allowance (JSA) claimants.

Finally, we make recommendations from our research which aim to improve the position of low-income workers engaged in agency work.

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1 See HMRC's statement in Appendix 5.

4. The birth of PDPD

As we have seen, where agency workers are employed using overarching contracts of employment, the various end user client sites are turned into temporary workplaces for the purpose of meeting s338 ITEPA 2003, and home to work travelling expenses are tax deductible as a result. However, it could be the case that Parliament intended this rule to have a much stricter application – applying for example, to a London-based businessman attending a one-off meeting in Edinburgh, enabling tax relief on travel expenses between his home and Edinburgh. To many people then (without even considering the problems that can often come with them), umbrella arrangements are objectionable because the underlying rules are being used in a way that was never intended.

The 2008 consultation

In 2008, in a consultation entitled *'Tax relief for travel expenses: temporary workers and overarching employment contracts'*[1], the Government looked at umbrella companies, stating:

> 'It was not the original intention that relief should be given for such journeys and it is unfair that some get tax relief when others working in similar circumstances do not. The Government wishes to consider whether there is a case for continuing to give relief in this way through these sorts of arrangements.'

The consultation outlined two broad options:

- 'Allow the existing arrangements to continue but introduce legislation to tackle non-compliance; or
- Remove entitlement to tax relief for travel expenses for umbrella companies and employment agencies using overarching employment contracts.'

A wide range of organisations and individuals responded to the consultation, including many umbrella companies, employment agencies and individual contractors who put forward a range of arguments as to why the Government should leave the schemes untouched.[2] Perhaps surprisingly to those outside the industry, the Government did just that.

Instead, the outcome of the consultation was that HMRC, as the authority that issued dispensations and enforced the expense rules, were to tighten up enforcement of the existing law:

> '5.104 Following the consultation Tax relief for travel expenses: temporary workers and overarching employment contracts, the Government have decided to leave the current rules unchanged. However, in the light of evidence from the consultation confirming poor levels of compliance in this area HMRC will refocus its efforts to ensure that the current regime is properly applied. If compliance does not improve, the Government may return to this at a later date.'[3]

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1 A copy of the consultation document can be accessed here: http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/media/F/2/travelexpenses_210708.pdf

2 For example see http://www.contractorcalculator.co.uk/lawspeed_aemc_treasury_contractors_expenses_300610_news.aspx

3 See the November 2008 Pre-Budget Report, page 104: https://www.gov.uk/Government/uploads/system/uploads/attachment_data/file/238690/7484.pdf

Not long after this, HMRC issued a Revenue & Customs Brief 50/09[1] (a short bulletin giving information on developments and changes of interest) confirming that they had started 'compliance activity to identify and take action against those… umbrella companies which are operating in contravention of tax, National Insurance or national minimum wage legislation'. The brief set out the background to the issue and confirmed that 'compliance activity has identified a number of concerns that are the subject of more detailed, ongoing investigation'.

The identified concerns included:

- 'Potentially ineffective overarching employment contracts
- Dispensations which are invalid, or which have been wrongly applied
- Not complying with the terms of the dispensation
- "Expense payments" made tax-free without that level of expense, or in many cases any expense, having been incurred
- Potential illegal deductions from workers' pay
- Ineffective and sometimes unlawful management processes; and
- Breaches of national minimum wage'

The content of Brief 50/09 indicated that HMRC had picked up the problems that existed with some umbrella companies and were starting to deal with them. However, the subsequent fast growth and spread of umbrella companies – from the professional contracting industry through to locum nurses and supply teachers, then on to general agency temporary workers and into the GLA sector, suggests that little else was done at that time.

The 2010 consultation

Umbrella companies operating in GLA sectors who employ workers directly must hold a GLA licence and must comply with various standards, including tax and HMRC-administered matters relevant to this report (on PAYE, NIC and NMW).

In late 2009, the GLA had become aware of some companies operating in their sector which were non-compliant with those standards in relation to travel schemes and issued a statement[2] of how they proposed to enforce the rules. They highlighted the fact that umbrella companies were paying cash wages below the NMW, making up the balance with reimbursed home to work travel expenses (which at that stage counted towards the minimum wage). They stated that they had seen 'minimum wage workers have well over 50% of their pay attributed to expenses, leaving their actual salary and the taxable amount as low as £97 for a 38hr week'.

Such concerns contributed to the 2010 consultation on *'Travel and Subsistence schemes for those on the National Minimum Wage'*[3]. Despite the Government previously seeming to have accepted the overall concept of umbrella companies by not taking stronger action as a result of the 2008 consultation, it now sought views on preventing

1 http://www.hmrc.gov.uk/briefs/income-tax/brief5009.htm

2 See http://www.gla.gov.uk/PageFiles/1054/Travel%20and%20umbrella%20schemes%20release%20final.pdf and the subsequent GLA Brief – Issue 3, 2010 http://www.gla.gov.uk/PageFiles/1048/GLA%20Brief%20Issue%203%20-%20Travel%20Schemes%20and%20Umbrella%20Companies.pdf

3 See https://www.gov.uk/Government/consultations/the-national-minimum-wage-travel-and-subsistence-expenses-schemes

workers at or on the NMW from partaking in such arrangements. The consultation document stated that the Government felt that such arrangements for workers at or near the NMW were undesirable because (as in 2008) they were a risk to the Exchequer and caused a tilt in the playing field. In addition:

- The arrangements were exploitative – although the worker typically was better off from using an umbrella company, the umbrella company made more out of it – through a combination of their fee, the reduced employers' NIC and sometimes a 'lost sacrifice' (this happened when the amount the employee agreed to sacrifice was more than the amount paid to him in expenses, with the difference accruing to the immediate benefit of the umbrella company).

- NMW workers were reducing their pay on which NICs were paid – potentially to below the point at which future entitlement to benefits accrued (the Lower Earnings Limit (LEL)). This put at risk their ability to achieve the qualifying earnings factor and may have affected entitlement to certain earnings-related contributory benefits, in particular the State Pension and working-age contributory benefits, such as Employment Support Allowance and JSA.

Whilst clearly being in favour of protecting low-income workers, LITRG feared that the proposed changes to address the above problems would not have the desired effect and could in fact worsen the financial position of some umbrella company workers who were signed up to travel schemes. Our response highlighted a number of points, for example that no consideration had been given to the situations in which income-based alternatives to contributions-based benefits might be available or when National Insurance credits (available when receiving various benefits – including working tax credit or child benefit) would be placed on the worker's record, effectively restoring their entitlement to certain other benefits. We recommended instead that the Government review travel expenses across the board – for tax, tax credits, benefits and NMW[1].

While we are now in the position to welcome the launch of such a review, finally published on 6 August 2014[2], back in 2010, our request for a detailed review of the system was not taken up.

The Government's proposals

The Government's view was that the 'problem' to be fixed was that reimbursed home-to-work travel expenses were counting towards NMW pay: at the time, expenses of travelling to a temporary workplace for NMW purposes were considered to be private rather than employment-related – no recognition of special temporary workplace circumstances existed for NMW, as it did in tax law. Thus, carrying on the example from the previous section, an employer could pay £97 in taxable salary and make up the difference (let us say the NMW level for 38 hours work was £200) with reimbursed temporary workplace expenses of £103 and still meet the NMW law.

The Government's solution was to amend the NMW Regulations so that where expenses were paid by employers to staff specifically in respect of travel to a temporary workplace, these would not count as pay for NMW purposes. Essentially it was intended that employers would have to reimburse any travelling and subsistence expenses *in addition* to a gross salary equalling the NMW, meaning the end of those paid at or around the NMW being able to sacrifice salary in order to receive a portion of their pay in tax and NIC free expenses.

As many agency jobs are paid at the NMW rate (particularly in GLA sectors), this change was obviously not welcomed by the umbrella companies. The changes to the regulations were challenged under Judicial Review proceedings in the *Cordant* case[3], heard just before the changes were to be implemented.

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1 See our response – http://www.litrg.org.uk/Resources/LITRG/1_782_LITRG_NMW_6May2010final.pdf

2 See https://www.gov.uk/Government/consultations/travel-and-subsistence-review

3 The Queen on the application of *Cordant Group plc v Secretary of State for Business, Innovation & Skills [2010]* EWHC 3442 (Admin) – see http://www.employmentcasesupdate.co.uk/site.aspx?i=ed7525

The Cordant case

The Cordant Group plc employed 30,000 staff in the UK and Ireland, many of them in unskilled jobs that are paid at or near the NMW. For some time, it had operated umbrella arrangements that would have been affected by the legislative change. As such, they challenged the amendment to the NMW regulations which was to apply from 1 January 2011.

The challenge was made on various grounds including the 'inequitable' treatment of the lower-paid workers and the alleged failure to comply with the general equality duty (as migrant workers and females would be disproportionality affected).

Whilst Judge Parker noted an imperfection in the amendment (discussed later) he rejected all grounds of challenge stating:

> 'I can discern no arguable basis why this amendment, which in what I have found to be the lawful conclusion of the Secretary of State brings substantial benefit to low-paid workers, and is in the public interest, should not be implemented, as planned and announced, on 1 January 2011.'

To the question of some of the lowest paid in the economy seeing their income fall overnight, he said:

> 'It is not an unavoidable consequence… that, to the extent that employers cease to offer salary sacrifice schemes to low-paid workers, such workers will suffer a significant loss of income. On the contrary, the Secretary of State has good reason to believe that one feasible and by no means unrealistic response… would be to pay their workers at least the minimum wage and also to pay, by way of Section 338 expenses, a relatively modest increment to ensure that their workers were not significantly worse off...'

But the low hire rates that end clients often insist on meant that margins were tight throughout the supply chain, so no increase to pay levels took place. On the basis that they could no longer replace salary with expenses, meaning that the immediate tax and NIC savings no longer existed, umbrella companies would not find it profitable to offer overarching contracts to low-paid workers. The workers would be transferred away from employment contracts with the umbrella company back onto agency contracts – thus denying them the ability to offset their travel costs altogether.

As such, a differential structure would occur, where workers paid at a certain margin more than the NMW could partake in travel and subsistence schemes, but those on lower pay (once again having to use standard agency arrangements) could not. This could be considered a somewhat odd outcome given that the 2008 consultation stated that it was 'unfair that some get tax relief when others working in similar circumstances do not'

An imperfection

The very specific 'temporary workplace' amendment to the NMW Regulations only stopped the counting of expenses *reimbursed* being treated as counting towards pay[1]. What was not changed was the treatment for NMW purposes where the worker incurs such expenses *that are not reimbursed* and Justice Parker highlighted this in footnote 2 to the judgement in the *Cordant* case:

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1 'Amendments to the National Minimum Wage Regulations 1999

2 In paragraph (1) of regulation 31 of the National Minimum Wage Regulations 1999(1) (reductions from payments to be taken into account), after sub-paragraph (i) add – "(j)any money payments paid by the employer to the worker in the pay reference period in respect of travelling expenses that are allowed as deductions from earnings under section 338 of the Income Tax (Earnings and Pensions) Act 2003(2)."' See – http://www.legislation.gov.uk/uksi/2010/3001/regulation/2/made

> 'It might be noted in passing that the alignment does not appear perfect. If the worker himself met expenses out of total income, and properly deducted them under section 338, his income for tax and NIC purposes would be the net amount after deduction, but it appears that the minimum wage would remain the amount of total income.'

This was an interesting observation, given that the consultation document stated that it sought to protect the interests of workers at or near NMW. However, it would have been far more wide reaching if the amendment had rendered expenses which qualify for tax relief under the temporary workplace rules as no longer counting as pay for NMW purposes, whether or not reimbursed by an employer. This would have benefited countless other low-paid workers outside travel and subsistence schemes – care workers for example, where their clients' homes can be temporary workplaces but who are rarely reimbursed fully, or at all, for their costs in getting to them.

Such an amendment would have had the effect of redefining NMW for them as the base rate plus the costs of travel and subsistence related to a worker's attendance at a temporary workplace. For example, if on the NMW of £6.50 per hour, a care worker incurs £10 a day in temporary workplace travel expenses over an eight-hour shift, the rate required to be paid by the employer to meet NMW would be £62, or £7.75 an hour.[1]

The birth of PDPD

It did not take the industry long to develop a 'solution' to the change in the NMW regulations. On 5 January 2011, the following comprised part of a press release from a 'specialist advisory practice [providing] practical and commercially sound advice in relation to all aspects of employment taxation throughout the UK and Ireland':

> *'So what next for travel schemes……..?*
>
> The answer may lie in a passing comment made at the foot of the judgement in Note 2 where Mr Justice Parker acknowledges that the alignment between tax and NIC legislation and the NMW Regulations is not perfect. He correctly… concludes that qualifying business expenses under s338 ITEPA 2003, which are met by the worker himself (and not paid by the employer), are deductible for the purposes of tax and National Insurance, but total remuneration will be maintained for the purposes of calculating the minimum wage.
>
> There is no doubt that employment businesses will wish to avoid removing their travel scheme for low-paid workers in favour of a strict PAYE model that would significantly increase payroll costs and reduce take-home pay.
>
> As mentioned earlier, the answer may lie with Mr Justice Parker who highlighted an imperfection in the amendment, and helpfully clarified that expenses incurred by the individual are not to be deducted when calculating the minimum wage.
>
> Instead of a salary sacrifice, employment businesses may wish to consider an arrangement whereby tax relief under s338 ITEPA 2003, available to each employee (relating to expenses met by the employee), can be used to reduce the amount on which tax and NIC is calculated, whilst not reducing total remuneration for the purposes of the minimum wage.
>
> This option would provide a significant financial and administrative benefit to the individual and a 'marginal' but nonetheless attractive saving to the employer.

1 We mention in passing that ideally, we would like to see a change to the NMW rules so that unreimbursed temporary workplace travel expenses are not included in the calculation, however we appreciate that this is problematic as it would have wide implications for employers who would essentially be required to meet the workers' costs in full. It may be the case that this topic justifies further exploration and analysis in its own report at some stage in the future.

It could be implemented simply and efficiently by the employment business or a compliant umbrella company through an expenses dispensation and a robust expenses policy and verification process, leading to a level playing field and the eradication of perceived exploitation of low-paid workers under a salary sacrifice arrangement.'

Thus a variant of the PDPD umbrella scheme developed. It is our understanding that the umbrella company market effectively split into two:

- the original type of umbrella company which followed the spirit of the NMW change, meaning their structure would now suit only those earning about £10 an hour or more (so as to allow for a salary sacrifice but still keeping clear of the NMW base rate), and

- those continuing to operate at the lower income end of the scale, at or around the NMW, following a PDPD type model.

The original umbrella structure was difficult enough to understand, particularly for low-income workers who, as we describe in the introduction, might face barriers such as not having English as a first language, or may be vulnerable in some other way – perhaps just through not being at least broadly familiar with how things in the tax system should work. The PDPD model added a further layer of complexity for workers as it was still first and foremost an umbrella arrangement but involved neither salary sacrifice nor an explicit payment of expenses by the employer.

Instead, the employer applied tax relief via the payroll to a worker's personally incurred travel and subsistence expenses. In addition, a NIC deduction at source was administered (the employer also paying less secondary NIC). With regard to the NMW, the simple presentation being made by PDPD providers was that they were complying with the rules as the employees were being paid at the required level because their home to work expenses, borne personally and not reimbursed, still count towards NMW pay.

We look at the rationale behind this treatment in the next chapter.

5. A closer look at PDPD

We have included in this report at Appendix 3 a copy of a PDPD scheme explanatory statement, in which certain legislation, case law and HMRC internal guidance is listed which we are told 'supports the payroll model' (the 'payroll model' being another term used to describe PDPD).

As campaigners for low-paid workers, it is hard to take issue with the 'aims' of the model: firstly that the umbrella aspect of it provides a framework within which the worker's placement locations can be temporary workplaces; but, secondly, that the relief-at-source aspect of it helps overcome some of the disparities that seem to exist under current law when higher paid workers get their expenses reimbursed, but low-paid workers do not.[1]

But where umbrella arrangements are 'legal', the question as to whether PDPD style relief-at-source is permitted under current law is another matter altogether.

Technical explanation

We understand that PDPD scheme advocates say that giving a tax deduction though the PAYE system is justified because HMRC are permitted to allow non-standard methods for operation of the PAYE system (under s684 (7A) ITEPA 2003). Further, this is in accordance with the whole aim of PAYE, which is that the total amount of tax deducted from an employee's pay over the course of tax year matches the employee's overall tax liability for the year.

With regard to the NIC deduction, it seems that PDPD providers are saying that an alternative interpretation of the legislation is possible, allowing a NIC deduction in cases of non-reimbursement and this is what was intended by Parliament all along. They seem to be relying on a particular construction of the rules in Schedule 3, Part VIII para 3 of the Social Security (Contributions) Regulations 2001 which disregards 'a payment of, or contribution toward, travelling expense which the holder of an office or employment is obliged to incur and pay as the holder of that office or employment' and where the term 'disregard' is being taken to mean 'deduct'. In addition, we understand prominence is put on the fact that nowhere does it refer to an expense payment having to be made by an employer.

The legislation referred to above has been reproduced as Appendix 4.

Further, the 'protection' of a dispensation is applied as is the ability to calculate subsistence expense deductions in accordance with the Benchmark Scale Rates (which are requested as part of a dispensation application). It is commonly accepted that a Section 65 ITEPA 2003[2] dispensation can apply to remove payments or reimbursements to an employee in respect of temporary workplace expenses (falling within Chapter 3, Part 3 of ITEPA 2003 and Chapter 2, Part 5 of ITEPA 2003) from a PAYE/return requirement. It seems that the PDPD providers claim

1 For example: some expenses are permitted tax relief in instances of reimbursement, but are denied a corresponding deduction in instances of non-reimbursement (for example passenger payments). Additionally, where tax relief may be claimed even if the expenses are not reimbursed, there is no NIC deduction for that expense. For example, if an employee travels 100 miles in his own car to a work conference carrying a fellow worker, then he can be reimbursed £50 tax and NIC free by his employer (essentially saving a basic rate tax payer £16 in tax and NIC). However, another employee in exactly the same circumstances who is not reimbursed, can only make a tax deduction claim for the £45 mileage and this would only be a tax claim, not a tax and NIC claim (saving him £9).

2 See: http://www.legislation.gov.uk/ukpga/2003/1/section/65

the benefits of the dispensation by virtue of earmarking a portion of salary as expenses (on the basis that an employee's salary is inherently made up of a combination of salary for the value of the work performed and expenses incurred) and thus some 'facility' is made by the employer in respect of expenses.

PDPD in action

We can see the PDPD mechanism in action on this reproduced real life 2013/14 payslip provided to us by TaxAid[1] – a charity offering up-to-date information and advice on tax matters to individuals on low and modest incomes.

Umbrella Company Ltd **Tax Period: 36 (Week ending 08 December 2013)**

Employee No:	Employee Name	Process Date	Ni Number
		13.12.2013	

Contractor statement

Agency receipts (2)	Units	Rate	Amount	Company Deductions	Amount
Rate	35.75	6.31	£225.58	Expenses subject to tax relief	£77.58
Employer's NIC			£0	Paid to employee	£131.00
Company Margin			£17.00		

Payslip

Employee Payments	Units	Rate	Amount	Employee Deductions	
Basic Pay	1	£131.00	£131.00	Tax	£0
Expenses Tax Relief	1	£77.58	£77.58	Employee NIC (7)	£0
					£0
Total Gross Pay			£131.00	Net Pay	£208.58
Tax Code			944L	Payment method	BACS

The worker under the PDPD scheme in this example has had no tax and NIC deducted. For comparison purposes, a worker earning £225.58 in that same week but not in a PDPD scheme could have expected to see deductions of some £8.71 in tax and £9.18 in NIC. The employer has also saved NIC of £10.70. Thus, on the face of it, the PDPD model saved this worker £17.89 as there have been no tax or NIC deductions on this payslip due to the value of the expenses purporting to reduce the taxable and NICable salary below the relevant weekly thresholds (£182 for tax and £149 for class 1 primary NIC, for 2013/14). The taxable pay is still above the LEL of £109 per week for 2013/14, so the employee is still accruing rights to state benefits.

However, because of the 'company margin' (the fee paid by the worker), the worker is only £0.89p better off than he would have been outside a PDPD scheme – and that assumes that HMRC do not challenge the comparatively large ratio of 'expenses' to salary. If they do, then this employee could find himself worse off than had he simply been paid normally – that is, he would have suffered the 'company margin' and possibly also find himself being pursued for the under-deduction of tax. He may also have a tax credits overpayment if he reported his income as the net of 'expenses' amount and HMRC then argue that the expenses were not allowable.

Whilst we appreciate that umbrella companies are commercial businesses providing an employment 'service' to workers so that the fee is to pay for more than simply the payroll function, a financial saving of only £0.89p for the worker compared to a 'company margin' of £17 a week plus secondary NIC savings for the employer (particularly when multiplied across the entire workforce) suggests that this employer operates PDPD principally for their own benefit.

1 See http://taxaid.org.uk/

HMRC's view

In July 2011, HMRC issued a 'statement'[1], outlining their 'view' of PDPD models. They seemed to make two main points – first that 'in-year' claims do not fit within legislation and second, that the NIC disregard does not apply. However, the medium of the message was unusual. It was not a Revenue and Customs Brief and it did not appear to be a Statement of Practice – the usual ways for HMRC to give public statements of their understanding of the law. Neither did the content form part of an HMRC internal manual, which generally offer some insight into the thinking of technical specialists on particular issues. It was not even a press release. As no one was sure of the statement's 'status', it was a confusing way for HMRC to inform taxpayers of their view on PDPD.

Nevertheless, the statement set out HMRC's view of the law and said that they could see three potential scenarios:

Scenario 1

An employer separately and distinctly pays/reimburses expenses under a valid dispensation
= no tax/NIC due from employer or employee

Scenario 2

An employer separately and distinctly pays/reimburses expenses under an invalid dispensation (or no dispensation)
= Tax due (but employee can claim tax relief at the end of the tax year)
= No NIC due from employer or employee

Scenario 3

Expenses are paid by employee out of salary
= Tax due (but employee can claim tax relief at the end of the tax year)
= NIC due from employer and employee

Interestingly they concluded their statement by inviting those operating the PDPD relief models to 'consider whether your business model is compliant with tax and NIC legislation'. Unfortunately, many scheme advocates noted the somewhat passive stance and decided that this fell short of suggesting that employers should cease using such arrangements:

> 'Using carefully selected phrases such as "HMRC understands that…" Information obtained by HMRC thus far indicates"…… might just suggest that HMRC is far from confident that it has got the technicalities right.'

HMRC's statement was clearly not sufficient to warn off PDPD scheme operators.

A second HMRC statement was issued in August 2012[2]. This focused on the use of dispensations and in particular it seemed, the use of Benchmark Scale Rates saying:

> 'Scale rate payments and the Advisory Benchmark Scale Rates can only be used for expenses made to or provided for any employees by the employer and where agreed as part of a Dispensation: they cannot be used by an employer to arrive at a sum on which tax and NICs 'relief' is given each pay day where the expenses are incurred by the employee and not reimbursed by the employer.'

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1 Now found in the National Archive at http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/news/relief-models.htm, text reproduced as Appendix 5 to this report.

2 Now found in the National Archives, see http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/news/news290812.htm, text reproduced as Appendix 6 to this report.

There is no legislation relating to the payment or reimbursement of subsistence expenditure, only HMRC guidance and although there is a precedent for employees claiming 'round sum' amounts rather than actual expenses when making a claim for tax relief for unreimbursed expenses, for example when claiming business mileage rates (with the potential for them to make a small 'profit'), in this statement HMRC clearly ruled out permitting such a concession for low-paid workers using PDPD schemes.

Yet this statement was apparently interpreted narrowly by some, seeming to concentrate as it did, on one aspect of the PDPD model that HMRC have said was non-compliant in its entirety. The operators seemed to conclude that the problem with PDPD was more about the quantification of subsistence deductions than the mechanism being used to provide those deductions and evolved into what seems to have been termed an 'actuals' PDPD model.

Actuals PDPD model

The following appeared on a PDPD adviser's website not long after the August 2012 statement:

> 'As predicted, HMRC have finally made clear that a dispensation is not appropriate for (the relief mechanism) due to that fact that there is no "payment" of expenses made by the employer. As a result, Benchmark Scale Rates (BSRs), which are approved as part of a dispensation, cannot be used to calculate an employee's entitlement to day subsistence.
>
> The fact of the matter is that by eliminating the need for a dispensation, implementation of (the relief) has just become easier to administer, due to the removal of the qualification criteria associated with day subsistence under the Benchmark system (including auditing).
>
> [Umbrella Company] currently has the facility to implement an 'Actuals' model, calculated on actual expenses incurred', for the subsistence element of any worker claim. (The only section affected by a dispensation.) We recommend (after consulting your tax advisor), that any clients who currently use BSRs, as part of a dispensation, move to an 'Actuals' model.
>
> On sign up, prior to starting on site, each employee will be asked to estimate his travelling expenses (including actual subsistence costs) which will be applied each working day. [Umbrella Company] will ensure that the correct amount of tax relief is applied each week by contacting the employee at least two days before every payment, to confirm the level of his current claim. If his estimate is incorrect, the claim will be amended to arrive at the correct result.
>
> As in the case of BSRs employees will still need to be able to justify the level of expenses, either by retaining receipts or completing a daily record of expenditure.'

This new iteration of PDPD purported to overcome the 'problem' with the old model around the application of BSRs. Other 'tweaks' to the model, perhaps to address accusations of opaqueness and exploitation, saw expenses now being reported to HMRC at the end of the year on form P11D and fees that were more moderate (with workers receiving at least half of the 'saving').

However, throughout this period of adjustment and refining, questions as to the fundamental 'legality' of the scheme seem to have been dismissed by scheme providers on the basis that HMRC had not provided any technical analysis justifying their position, nor had they built on their views outlined in July 2011 and August 2012. Such comments were being made openly in the public domain but HMRC issued no further statements in retort.

The problem of statutory interpretation

It is very rare for legislation to specifically address all matters. Often there can be drafting errors or unforeseen

situations; but even if there are not, words can be capable of more than one meaning. We have seen that by the application of a specific interpretation of the words in the legislation, an alternative construction of the law has been arrived at by PDPD providers to justify certain aspects of the model.

HMRC administer the tax law, they do not make it. While HMRC may issue descriptions of how they view the law and intend to apply particular legal provisions, taxpayers are free to interpret the law in a different way. Ultimately, such different interpretations will only be resolved if they are tested in the courts, which then must interpret the words in the statute and decide what they mean. Where words are capable of more than one meaning, it is likely that the court will ask itself what the intention of Parliament was and give an interpretation that best gives effect to that.

In late 2012, the arguments around interpretation were actually heard by a judge in the FS Commercial case[1], but in an unusual context: the GLA had refused FS Commercial an operating licence on the basis of their PDPD model and this decision was now being challenged in the GLA Tribunal.

FS Commercial Limited (FSC)

FSC, an umbrella company, were proposing to operate a PDPD tax relief model in the GLA arena. Following the HMRC statements outlined above, the GLA considered that the model breached two critical licensing standards.

FSC put forward in its application for a licence from GLA, a proposed model of operation involving the following steps from a PAYE and NIC perspective:

> '37.1 Where a worker provides satisfactory evidence that he or she has incurred and borne deductible travel expenses for a payment period, FSC will take account of the deductibility of such expense in determining the amount of PAYE which should be deducted from the payment of wages for the period.
>
> 37.2 Subject to the provision of satisfactory evidence, in computing the amount of a worker's earnings, on which primary and secondary class 1 NIC are to be charged, FSC will deduct an amount equal to the deductible expenses incurred and borne by the worker in the earnings period. Accordingly both the amount of the primary and the secondary class 1 NIC will be smaller and the smaller amount will fall to be deducted from the worker's weekly or monthly payments. The appellant [FSC] will pay the smaller secondary class 1 NIC out of its own resources and will recharge such secondary class 1 NIC to the agency, to which it is supplying the services of the workers.
>
> 37.3. The appellant will offer its employees the opportunity to engage the services of a separate, associated company, FSEV Ltd ("FSEV"), to advise and assist the employees on the deductibility of travel and subsistence expenses, the preparation of claims and their entitlement to other state benefits such as Working Tax Credits. Services will be provided to the employee in return for the payment of a fee by the employee to FSEV. The employee will be required to mandate FSC to pay the fee to which FSEV becomes entitled out of his or her wages.'

FSC put forward a number of arguments as to why this model was not in breach of HMRC's rules and therefore why the GLA should not deny them a licence. For instance they seemed to claim that their dispensation provided 'authorisation' to operate PAYE in a non-standard manner. They also asserted that paragraph 3 of Part VIII of Schedule 3 to the NIC regulations should be construed purposively – i.e. that 'a payment of, or a contribution towards, travelling expenses' was intended to be and should be read as two separate limbs:

1 *FS Commercial Ltd v Gangmasters Licensing Authority* [2012] See full case report at: http://www.gla.gov.uk/PageFiles/1475/FS%20Commercial%20Ltd.pdf

- a payment by the employee; and
- a contribution by the employer.

Further, they claimed that some passing comments of Judge Parker in the *Cordant* case[1], where he seemed to say that expenses should be free of tax and NIC even if personally incurred, supported this interpretation.

The Judge did not accept these arguments, finding that FSC's interpretation of the Social Security regulations was an 'artificial construct' and that their proposed model was contrary to PAYE and NIC legislation. Accordingly, the GLA had been correct to refuse a licence.

She added:

> 'In all the circumstances I find that there is no merit in the argument that non-reimbursed travel expenses paid for by the employee should be disregarded for NI purposes. There is no merit in the argument that the provision should be interpreted to allow employers to deduct non-reimbursed travel expenses when calculating NIC. That may be unfair. However it is not for FSC… or me to rewrite legislation.'[2]

Similarly, she dismissed the giving of tax relief at source on travel expenses:

> 'In all the circumstances I find that deduction at source of Section 338 travel expenses paid for by the employee and not reimbursed by the employer is not allowed under the PAYE Regulations, is in breach of the Dispensation granted by HMRC to FSC. It was reasonable and wholly appropriate and proportionate for GLA to refuse a licence on the grounds that the PDPD model breached the critical standard 2.1.'[3]

It should also be noted from paragraph 128 of the judgment that she dismissed the Cordant case as irrelevant given that it was not 'relevant binding authority', saying: 'The statement of Mr Justice Parker is clearly obiter'.[4]

She concluded:

> '155. In conclusion I find that both the PDPD and Coding Models rely on the deduction of Section 338 travel expenses for the calculation of employer's and employees' NICs. I find that both models breach Standard 2.1 in this regard. It is not appropriate to grant a licence to FSC which, in its current operation, breaches NIC legislation and proposes to do so for its proposed gangmasters operation. The fact that FSC has operated this system for a number of years, in breach of its Dispensation, and without appropriate action being taken against it by HMRC, is unfortunate but does not detract from the fact that the practice is unlawful, a breach of Standard 2.1.
>
> 156. I find that FSC's current and proposed PDPD model breaches the PAYE Legislation. FSC has not obtained approval or dispensation from HMRC for the operation of either PDPD or the Coding model.'[5]

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1 Judge Parker had made comments like: '26: For the purpose of determining the amount of remuneration chargeable to income tax and NIC, section s338 expenses are discounted. … Such expenses are necessarily incurred in the performance of the employee's duties qua employee. He or she cannot perform the job without incurring them… Such expenses therefore, may not fairly and reasonably be treated as forming part of the worker's remuneration, or the pay that he or she would otherwise apply to current consumption or saving and do should not form part of the amount upon which tax and NIC are charged.'

2 Ibid, end of paragraph 128 of the judgment.

3 Ibid, end of paragraph 129 of the judgment.

4 Obiter dictum – a remark in a judgment that is 'said in passing'.

5 Ibid. Note that the 'Coding Model' referred to was another proposed alternative to its PDPD scheme for FSC to give tax relief via the PAYE system to its employees, explained at paragraph 39 of the judgment.

She also found that the deduction from a worker's wages to pay for FSEV's services was a breach of Regulation 32(1) of the NMW Regulations[1] (which provides that certain specified deductions have the effect of reducing the amount of NMW pay received by the worker), saying:

> '157. For clarity, I would add that each breach of the critical standards, the unlawful deduction of s338 expense borne by the employee in calculating NICS, the deduction of s338 expenses at source under the PDPD model and proposed Coding model, the deduction of FSEV's fee from the workers wage, would each separately and individually support my finding that each of the appeals is dismissed.'

The aftermath of FSC

This seemed, on the face of it, to be a strong decision against PDPD. However, while the FS Commercial case at least got some of the issues surrounding PDPD schemes heard in the courts, it was heard in the GLA Tribunal. So although senior representatives from HMRC were present throughout the appeal hearing to provide technical input to Counsel instructed by the GLA, the FS Commercial decision was not a 'tax case'.

The result was clearly an important one for the GLA, strengthening their position and providing the impetus for more compliance action on their part[2], but it seems the decision was taken as having little relevance apart from in the context of the GLA licensing standards. FSC themselves issued the following statement on 12 March 2013 in response to the judgment:

> 'It is plainly wrong for the GLA to declare that our payroll model is illegal as we have not received a financial assessment from HMRC upon which we are able to appeal. Although the judgment has denied us the opportunity to trade in the GLA sector, we continue to provide a compliant service outside of the sector.'[3]

Although the *FS Commercial* decision had some impact on PDPD operations (particularly in the GLA sector), the absence of binding tax precedent means that the schemes have not gone away. In fact, certain employers seem to have developed the model again, as we can see from this reproduced real life 2013/14 payslip and associated expenses statement provided to us by TaxAid below:

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1 Regulation 32(1(provides that: "32. (1) The deductions required to be subtracted from the total of remuneration by regulation 31(1)(g) are –
(a) any deduction in respect of the worker's expenditure in connection with his employment;
(b) any deduction made by the employer for his own use and benefit (and accordingly not attributable to any amount paid or payable by the employer to any other person on behalf of the worker), except one specified in regulation 33".

2 See for example this report of the GLA's revocation of UK Payroll's licence, dated August 2013: http://www.recruiter.co.uk/news/2013/08/gla-revokes-uk-payroll-licence-over-travel-and-subsistence/

3 See http://www.fscommercial.co.uk/2013/03/12/fs-commercial-respond-to-gla-statement/

Payslip				**Date 01/11/2013**	
Employee Payments	Units	Rate	Amount	Employee Deductions	
Basic Pay	55.50	£6.50	£360.75	Tax	£0
				Employee NIC (7)	£0
					£0
YTD Taxable Pay			£2,687.62	Net Pay	£360.75
YTD Tax Paid			£26.20		

Expenses claimed			
Previous unclaimed expenses balance			£93.23
1 Mileage	@	£82.35	£82.35
5 Two meal	@	£10.00	£50.00
Total including unclaimed expense balance			£225.58
Total expenses claimed for relief			**£211.75**
New unclaimed expense balance			£13.83
Summary:			
Net wage before tax relief applied			£299.94[1]
Net wage after tax relief applied			£360.75
Fee			£27.63
VAT			£5.53
PAID			**£327.59**
Net benefit to worker			£27.65

There are a number of interesting aspects to this payslip. Firstly, we can see from the above that BSRs are being used. Notwithstanding that HMRC's guidance says that BSRs should be used only when a payment is made by an employer, the 'two meal' rate is also applicable only if the worker 'has been undertaking qualifying travel for a period of at least 10 hours and has incurred the cost of a meal or meals (food and drink)'.[2] If the worker in this situation is taking a packed lunch to work each day, a significant underpayment of tax and National Insurance could be accruing.

Secondly, it is interesting to note that expenses have been taken as deductions only so far as the net salary is reduced to the primary threshold where NIC starts to be paid (£149 in 2013/14) – a piece of 'planning' often used by Directors of their own companies who are able to pay themselves in such a combination of salary and dividends as it minimises their tax and NIC bill but maintains their entitlement to contributory benefits. There is a carry forward of the excess – presumably to be offset in a later pay period (and we can assume that this is why there is an expenses balance carried forward).

Thirdly, we note that the 'fee' is not paid to the employer, but to an associated expenses company. We assume that this is to try and avoid problems with low-paid workers and the NMW as this kind of deduction by an employer is usually taken into account when calculating the NMW (as noted in the FSC case). It seems here that the parties involved consider this is not to be an issue if the fee is paid to a 'third party', but interestingly the addresses of the two businesses are the same.

1 'Calculated as Tax: £360.75- £182 x 20% = £35.75, NIC: £360.75- £149 x 12% = £25.41. Total deduction £61.

2 See HMRC Manuals EIM05231: http://www.hmrc.gov.uk/manuals/eimanual/eim05231.htm

What might HMRC think?

The *FS Commercial* case informs us of HMRC's possible view of this situation, however, it falls short of setting tax precedent. We have not found that any case has yet been heard in the tax tribunal on the subject, although we did find some commentary that, in early 2013, HMRC might have been intending to pursue a PDPD case against a company called Legitas. After initially making a statement that the company was changing its payroll practices[1], Legitas and other group members went into Creditors Voluntary Liquidation[2]. HMRC reportedly claimed some £58million was owed to them[3], however no official comment was ever made from HMRC on the case.

This left some speculation as to whether the actual cause of the liability was down to a technical failure of relief at source mechanism, or some other reason.

Indeed, it seems there was still enough ambiguity about the legality of the PDPD mechanism to merit the matter finding itself back on the agenda at various recruitment industry updates during 2013. We have seen slides from law firms and tax practices on PDPD models, not suggesting that umbrella companies cease using such arrangements, but instead containing phrases such as: 'make sure you understand the risks'; 'ensure the only point for debate is the key technical principles'; and 'consider clarifying position with HMRC'.

1 As reported by 'Recruiter' on 18 April 2013 – see http://www.recruiter.co.uk/news/2013/04/legitas-switches-temps-to-paye-after-concerns/

2 The company was insolvent and placed into liquidation by its directors, see https://www.gov.uk/liquidate-your-company/creditors-voluntary-liquidation

3 See report at http://www.heraldscotland.com/news/home-news/edinburgh-firms-enter-liquidation-after-58m-tax-claim.21393708

6. Our research and review of current HMRC action

As it is clear that PDPD is still in operation, we wanted to try to understand for ourselves how widespread the schemes are. We therefore undertook our own research. It was our understanding that if providers seemed willing to take on a worker at or around the NMW, then it was likely that they were operating a PDPD type scheme.

We emailed 100 umbrella companies with a request for information about how their service could help 'Paul', a worker who had just obtained a three-month temping agency contract as a warehouse operative for £6.50 an hour. We found these companies through an umbrella company comparison website[1] and thought 100 was a good size sample in light of the number of umbrella companies likely to be operating in the UK, which we understand to be several hundred.

The results were:

- 6 delivery failures (which could indicate something about the quick turnover of these businesses);
- 72 responses, meaning 22 did not reply to us at all.

Of the 72 responses, 35 outright said that they could not deal with such a low level of earnings, for example one reply said:

> 'We wouldn't take anyone on for less than around £10-£11 – our system will not allow us to.'

Indeed, many of the 35 went out of their way to provide a helpful explanation, one example of which was as follows:

> 'Going through an umbrella company means you can take home more, due to tax free expenses you can claim. However, being employed by an umbrella company means your hourly/daily rate needs to be a certain amount, to take into consideration employment costs. An umbrella company would pass the cost of Employers NI (13.8%), a Margin for the back office work and insurances, as well as taking into consideration pension contributions and holiday pay. These deductions would be taken from the funds received, meaning your taxable pay will go below National Minimum Wage which we cannot allow.'

Of the remaining 37 responses:

- 18 would not be drawn on an answer there and then and requested a phone call to discuss their services over the phone or requested further information, for example what the 'limited company rate' would be.
- 19 seemed to suggest that they might be able to help us further saying things like: 'Yes, you can sign up with us. Please email me your contact telephone number and I will arrange a call with more information.'

One email even sold the scheme to 'Paul' as follows:

1 http://www.umbrellacompare.com/

'Hi Paul

On umbrella solutions you can claim your travel food and all other work related expenses.

After deducting all the expenses HMRC taxes will be applied on your salary. Due to that reason umbrella solutions is always tax efficient and higher take home pay as compared to normal PAYE scheme.

Here is the example calculations:

Your total weekly gross earnings: 40 hours x £6.50 = £260
Your expenses including travel and others = £70

Employer's NI 1.64
Employee's NI 1.42
Employee Tax 0.00
Total All Tax 3.06
Fee 10.00
Total Net Income 246.00

If you choose typical PAYE employment scheme then your take home will be around £215.00/week.'

Therefore, our research suggested that there were still a number of operators in the market place, with up to 37% of providers not immediately rejecting our near-NMW worker.

We continued our research by a search of the internet. Even at a glance, it is easy to find promotional material for the low-paid model on websites (which mainly appeared slick and professional). For example:

'(our) scheme is designed for contractors with an hourly pay rate from NMW (currently £6.31) up to and around £8.00 per hour.'

'If your agency has minimum wage temporary workers then our Personal Relief (PR) Umbrella Model is for you. It's fully compliant and meets HMRC rules. This has never been done with Umbrella services and can save ERNI! Our software will incorporate RTI from April 2013, and is already auto-enrolment ready for when HRMC [sic] require this action.'

'With [our solution] you will see more money in your wage packet because we can legitimately reduce the amount of Tax and NIC you pay by processing your relief each time you are paid.
This is an 'Opt In' service, you choose if you want to take home more. If you choose to Opt In, you are still free to Opt Out at any time.

A web portal to record your expenditure and a verification service are provided by [independent expenses company] and they advise us how much Tax and NIC relief is due to you each week. [Independent expense company] charge a fee equal to half of the Tax and NIC relief you are entitled to.
No Tax and NIC Relief = No charge!

The comparison below demonstrates how much (our solution) can benefit a typical… employee.'

	Rate	Hours	Gross	Expenses	Taxable	Relief claimed	Fee	Better off
Without [our solution]	£6.31	40	£252.40	0	£252.40	0	0	0
With [our solution]	£6.31	40	£252.40	£50	£202.40	£16	£8	£8

'This product allows personal tax relief to be applied to workers, including those who are low-paid including National Minimum Wage. Whilst providing legitimate increased worker take home pay, it reduces payroll costs for the agency.

Key Benefits

- A worker's pay is not reduced, unlike umbrella salary sacrifice; therefore there are no… NMW issues.
- Expenses claims are individually assessed, per worker, per location…
- Qualifying expenses reduce NI liability.
- Legitimately reduces employer costs.
- Our GLA licensed companies remain able to trade within the regulated sector.'

Our research indicates that some of the PDPD schemes in operation do seem to be more moderate in operation, than those from which we have seen actual payslips. Nevertheless, the structure underpinning the new model has not changed, and we assume HMRC therefore still regard them as non-compliant.

What action is being taken?

The GLA is aware 'that some advisers are continuing to advocate the use of these (PDPD) schemes despite the recent (FSC) judgment' and as such have issued an updated Brief 39[1] which provides information on how the Licensing Standards affects businesses operating travel and subsistence schemes. Indeed it also seems they have revoked another 'GLA licensed' PDPD provider's licence but without 'immediate effect' – this means that they are entitled to trade under that licence until the outcome of their appeal[2]. (We understand that the appeal is listed for hearing in December 2014.)

In addition, 'All Umbrella Companies Are Equal' (an association of seemingly reputable umbrella companies set up to provide an unbiased resource for UK contractors) who themselves do not think PDPD is correct, continue to post blogs on PDPD to their website[3] in their quest to 'ensure any wrong-doings that are unearthed are highlighted in the public forum'.

However, it is not clear what action HMRC are taking. There have been no further public statements from them about PDPD since August 2012, and even the statements at that date and before can now only be found in the National Archive. The email address to which workers or other businesses could send details in confidence about businesses operating PDPD relief models also seems to be redundant. When we sent an email to it enquiring whether it was still active as we had some information about PDPD operators, there was no response.

Further, there is no basic information or reference to PDPD schemes on HMRC's website or in any of HMRC's literature on 'tax avoidance', for example in 'Spotlights'[4] – which 'warns you about certain tax avoidance schemes which HMRC thinks you should be aware of'. A search of the term 'Pay Day by Pay Day' using the search function on HMRC's website returns no relevant results.

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1 http://www.gla.gov.uk/PageFiles/1538/GLA%20Brief%20on%20Travel%20and%20Subsistence%20June%202014.pdf

2 http://www.recruiter.co.uk/news/2013/09/zeva-launches-appeal-against-gla-licence-removal/

3 See for example – http://www.allumbrellacompaniesareequal.com/2/post/2013/12/it-appears-that-some-companies-may-still-be-running-pay-day-by-pay-day-schemes.html

4 See http://www.hmrc.gov.uk/avoidance/spotlights.htm

We decided to ask HMRC directly what the current situation was with PDPD, sending them a letter requesting information under the Freedom of Information Act provisions[1]. Their reply is set out below:

> 'I refer to your request.....for the following information:
>
> *"Please could HMRC confirm how many operators of Pay Day by Pay Day tax relief models (or other similar names) have been identified and are under investigation/have been investigated for not being compliant with tax and Social Security legislation following the release of the two statements in 2011 and 2012 outlining HMRC's views on these models?"*
>
> Following a search of our paper and electronic records, I have established that HMRC does not hold the information you requested.
>
> The term "Pay Day by Pay Day tax relief model" has no statutory definition; rather it is a colloquialism which describes one type of a range of business models operating within the labour provision market. In the absence of a statutory definition of the term it is not possible for HMRC to identify the number of individuals or organisations that may be operating such a model. For the same reason HMRC cannot profile within its compliance systems such business models and cannot therefore provide details of the number of businesses operating such a model under investigation.'

Whilst we appreciate that the terminology is not a statutory definition and that other terms such as 'Pay Day Relief model' have been used in the industry to describe PDPD schemes and their variants, HMRC's response was somewhat surprising given they had recognised the use of the term 'pay day by pay day' in the two earlier statements they made on their website and had even stated 'HMRC is seeking to identify those businesses currently operating pay day by pay day relief models'.

We decided to try a different approach to HMRC on the basis that PDPD schemes essentially rely on a number of well executed background umbrella arrangements (an overarching contract, etc.) which can themselves be challenged in a number of ways as being ineffective. Indeed we are aware that TaxAid see 'flagrant breaches of the rules', i.e. where there does not seem to be a genuine overarching contract for a succession of different short term engagements, or where there has been clearly only been a single 'engagement', or where the expenses figures are clearly not valid:

> 'Perhaps we only see the worst cases but I would have thought that some of the cases we have seen would be fairly easy for HMRC to attack on facts, whatever the technical arguments (around PDPD)' - representative from TaxAid

Therefore perhaps HMRC had PDPD within their sights, but in the context of problems with umbrella companies more broadly. We wrote again and received the following reply[2]:

> *'"In the context of travel and subsistence schemes operated by some employment businesses and umbrella companies, how many employer compliance enquiries has HMRC undertaken by year, over the last five years, where the following have been material issues (or similar descriptors as used internally): 1) the legitimacy of expenses 2) the effectiveness of the overarching contract…."*
>
> Turning to your request, HMRC can neither confirm nor deny that it holds information that may fall within the description you have specified because we estimate that it would take more than the appropriate limit to ascertain whether or not we hold the information. This should not be taken as an indication that the

1 FOI 1322/14

2 FOI 1365/14

information you requested is or is not held by the Department.'

This was disappointing given that our request was fairly narrow in scope. We would have thought that if umbrella company compliance was a 'live' issue for HMRC, this type of risk analysis would be performed routinely and such information therefore would be readily available.

Interestingly, not long after receiving this response, it was announced that Reed[1], the employment agency, had lost their big umbrella expenses case against HMRC and now faced a liability of up to £158m.

The Reed case

This case dates back a number of years. We understand that in the late 1990s, Reed's advisers had suggested that the 1998 changes to allowable travel expenses were an opportunity to find a different way of paying its temps. Reed rarely took them on for only one assignment; although they might have gaps in their work (for which they were not paid), its temps would typically work at a succession of clients' premises, rarely for more than two years at a time. So Reed produced a number of travel schemes. The basic idea was that the employees sacrificed an element of their salary each week, and received a tax and NIC travel allowance in return.

However, in 2007, HMRC made assessments under the PAYE regulations to collect tax and NIC from January 2001 to April 2006, totalling some £158m.

It was common ground that one of the deciding factors was whether the workers had a single, ongoing, contract with Reed as they moved from assignment to assignment, given that there was no pay when the worker was not working. The judges felt that really each assignment was a separate employment, and that there was not sufficient mutuality of obligation between assignments to make the whole relationship continue from one assignment to the next (such that each assignment was at a temporary workplace justifying tax free travel expenses). Reed's contention that, between assignments, it may not have been paying the workers but it was using endeavours to find work for the workers was described in the decision as a 'shadowy obligation' and effectively ignored.

Binding case

While this case was not about the legality of the PDPD relief at source mechanism, it is an important – and binding – case on umbrella arrangements more generally, given that it was heard in the Upper Tax Tribunal. It therefore suggests we might be seeing HMRC taking a closer interest in the technicalities of umbrella arrangements in the future. Indeed, certain comments in the consultation document issued in June 2014 on the Reimbursed Expenses Exemption[2], lead us to believe that umbrella arrangements might be back on the Government's radar already:

> '4.13 The Government is aware of a number of arrangements that are used by a minority of employers which seek to replace taxable pay with payments of non-taxable expenses. Historically these arrangements have involved employees sacrificing an amount of their salary in exchange for being paid an equivalent amount of subsistence expenses. The primary purpose of these arrangements is usually to reduce the amount of NICs that the employer is required to pay. The arrangements are often aimed at low-paid employees.
>
> 4.17 The Government does not believe that these arrangements are in the spirit of the rules that provide relief for employees who incur qualifying expenses in the course of their work. The Government also does not believe it is fair that employers who enter into these arrangements gain a competitive advantage over those employers who seek to operate within the spirit as well as the letter of the law.

1 *Reed Employment plc & others* [2014] All ER (D) 153

2 https://www.gov.uk/Government/uploads/system/uploads/attachment_data/file/321201/expenses_exemption_180614.pdf

4.18 The proposed exemption provides an opportunity for the Government to tackle some of these arrangements and prevent them being used in the future. This would most likely be achieved through a targeted anti-abuse rule to prevent such arrangements being used in conjunction with the exemption.'

At the time of writing, the Government's intentions are unknown. It is also unclear as to whether any renewed interest in umbrella companies will involve a dedicated focus on PDPD schemes.

7. The worker's perspective

All of the complexity and uncertainty around PDPD schemes mean that they could be fraught with difficulties (even where the worker's expenses are wholly genuine) but nevertheless, it is easy for a worker to find themselves part of a scheme. In this chapter we look at some of the major factors which may be fuelling workers' continuing participation in them.

Lack of awareness of risks

Whilst taxpayers are responsible for their own tax position, it is important to appreciate that most people understand little about our system. The PAYE system discourages employees to engage with their tax affairs. The employer is the tax gatherer, administering an employee's tax for them and the employee can become very passive, assuming it is all taken care of. This is an excellent system when it works well, but it can contain pitfalls for the unwary.

Further, HMRC do not approve or accredit umbrella companies, but without any HMRC material countering claims of 'compliance', then these statements by scheme providers will be understood by many taxpayers to mean that there is nothing risky to worry about. Some workers – perhaps especially those without English as a first language or those with lower levels of education – simply do not understand the schemes. Even if they feel something is wrong with what their employer is doing with their pay and taxes, it seems they have little hope of understanding enough to question or query what is happening if HMRC are not really fulfilling their responsibility to provide information and make things as clear and easy to understand as possible.

As such, we would like to see HMRC providing user-friendly, targeted consumer information to agency workers (including appropriate warnings so that they can be informed in their choices) – recognising that those at the less sophisticated end of the taxpayer spectrum may not have the capacity to make sense of HMRC's current, one-size-fits-all style of material.

LITRG of course, would be happy to help with this, however we recognise that this will not provide a complete solution because, additionally, agencies might also be turning a blind eye to questionable practices by umbrella companies – not warning workers of any problems and perhaps even denying them work if they do not agree to join a scheme. We should remember that having an umbrella company in the picture reduces agencies' payroll obligations – an obvious incentive for them to use umbrella companies. Ultimately, they may be indifferent to what happens to the worker after the umbrella company has assumed the 'employer' function, as we can perhaps see in the case of Mr B.

Real life case study – Mr B

> Mr B is a construction worker. He found work through an agency, who recommended that he use an umbrella company. On Mr B's first payslip, we can see that the fee paid to the umbrella company is £12.50 – a fee at the lower end of the spectrum. However on closer inspection, we can see that Mr B has had zero expenses processed by the umbrella company. Mr B walks to work, and therefore has no travel expenses.
>
> While it is somewhat reassuring to see an expenses claim that actually reflects the reality, it is unfortunate that Mr B has paid a fee to become an employee of the umbrella company and use their overarching contract, if it was totally unnecessary.

Mr B has paid £12.50 for no reason – this is an instance where we might have expected the agency to process Mr B's wages themselves and not pass over his case to the umbrella company.

The fear factor

Even if low-paid, often vulnerable, workers are aware of 'problems' with schemes, there are two further factors which possibly contribute to their use, both fuelled by fear:

- First, workers' concern that if they fail to take up work offered to them, they will lose benefits; and
- Second, even if workers are uneasy about the terms and conditions to which they are signed up, they are likely to be afraid of reporting their employer to the authorities for fear of losing their job and what little income they have.

Loss of DWP benefits

Many who end up in low-paid agency work will be claimants of JSA and possibly other means-tested welfare benefits. JSA claimants have various strings attached to their claim, including the need to look for work and demonstrate that they are doing so. Failure to look for work, or to accept work when offered, may lead to 'sanctions' and a loss of benefit.

This fear of losing benefits might force a JSA claimant to accept agency work and in turn sign up to terms and conditions which include a PDPD travel expenses scheme. In reality, there may be little choice but to sign up to the scheme conditions in order to take up the work, but even if the worker suspects that all is not well, they fear possible sanctions if they do not.

To understand the DWP's position on this subject, it is necessary to consult the Jobcentre Plus Decision-makers' Guide1. In this, we find the following:

> '34339
> *Circumstances that may show good reason for a refusal or failure to apply for or accept if offered a job vacancy*
> …
> *Other circumstances that may amount to good reason*
> 34376 The DM should
>
> 1. consider all matters put forward by the claimant and
> 2. decide whether or not to take them into account when deciding good reason.
>
> 34377 Account should also be taken of any other factor that appears relevant. In particular when the terms of a job on offer break the laws on
>
> 1. minimum working conditions or
> 2. they knowingly connive with an employer or agency in a
> 2.1 tax avoidance scheme or
> 2.2 PAYE is not being properly accounted for.'

This is of some comfort, in that it appears the decision-maker should take into account the fact there are questions around the use of PDPD schemes and so not force a claimant to accept a position which involves signing up to its

1 See Chapter 34, JSA sanctions – https://www.gov.uk/Government/uploads/system/uploads/attachment_data/file/337585/dmgch34.pdf

terms, nor threaten them with sanctions if they do not.

But questions arise:

- Are the decision-makers schooled in the workings of tax, and tax avoidance schemes?
- Would they be able to assess whether a prospective employer is likely to account for PAYE correctly?
- Are they briefed on the existence of PDPD schemes and HMRC's statements indicating that they are viewed not to be compliant with tax and NIC law?

Given that the Decision-makers Guide appears to make no further reference to tax avoidance schemes, how to recognise one or where to go for further information, we suggest it is very unlikely that Jobcentre Plus staff would be able to put the above guidance into practice in reality.

A similar set of questions will arise under Universal Credit (UC) where the failure to accept a reasonable job offer can mean a claimant fails to meet the applicable level of conditionality, resulting in a suspension of benefit. We are particularly concerned about this given the Government's plan to force UC benefits claimants to take 'zero hours' contracts or face sanctions (unless there is an exclusivity clause in the contracts)[1]. This seems to indicate a general 'toughening up' by the authorities – pushing people to accept whatever is on offer whether or not the terms are favourable in their particular situation.

Losing one's job

The second fear, as noted, is that of losing one's job even if a worker suspects that a scheme to which they are signed up is non-compliant with tax law[2], or even minimum wage law[3]. Whilst it is all very well to say that workers can report NMW non-compliance anonymously for example (or that their details when making their complaint are protected), workers understandably fear that their employers might find out that they are the 'whistle-blower' or alternatively, might lose their job altogether if non-compliance is upheld and their employer becomes insolvent as a result of back assessment of tax, NIC and/or NMW liabilities.

We can certainly confirm that enquirers to the LITRG website who have found themselves in various different 'schemes' have been reluctant to give their real name, or send copies of payslips showing what is happening to them. They are likely to be even less forthcoming with the authorities themselves, and we have lost contact with enquirers altogether if we have suggested they make an official complaint – even an anonymous one.

Finances

We acknowledge that the Government has several measures already in place to support various groups with the costs of transport which are welcome, if limited.[4] However for the many low-paid workers who do not qualify for support under the benefits system, becoming part of something which promises them relief on their cost of travelling to work may be irresistible. This is particularly when viewed against the difference in the increase of the NMW in comparison to inflation[5] and the rising, yet non-tax deductible cost to the agency worker of getting to

1 http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm140512/text/140512w0002.htm#140512w0002.htm_wqn18

2 A report may be made to HMRC online, for example: http://www.hmrc.gov.uk/reportingfraud/online.htm

3 A NMW complaint can be made online, or by telephoning a helpline – see https://www.gov.uk/pay-and-work-rights-helpline

4 https://www.gov.uk/Government/publications/support-to-help-with-the-cost-of-transport/support-to-help-with-the-cost-of-transport

5 The real terms value of the NMW has taken a battering since 2008 – had the NMW kept pace with inflation (CPI) from 2008, the rate would be £7 today rather than £6.50.

their various workplaces.[1]

The scheme promoters attract workers by majoring on their inability to claim relief on travel expenses to temporary places of work under the current legislation, unless there is an overarching contract which links temporary assignments; however, it is worth mentioning that overarching contracts of employment also mean the workers gain wider employee rights. Under the alternative – a standard agency contract, not only would travel expenses be un-relievable but the agency staff would be considered 'workers' for employment law purposes[2].

In addition, workers paid at or around NMW who participate in an umbrella scheme have a prima facie additional entitlement to tax credits compared to those workers not in a scheme. Thus, they benefit not only from receiving increased 'net pay', but also receive extra tax credits – a double advantage above other workers who are employed in the traditional manner. (But this does not take into account the risks of subsequent challenge and tax credits overpayment if HMRC later determine that expense claims via the scheme were invalid.)

Tax Credits/Universal Credit

A person's entitlement to child tax credit and working tax credit is based upon his/her level of taxable earnings – against which permitted tax deductions are taken.[3] This means that a worker using an umbrella company where £50 of their £275 earnings are attributable to s338 travelling expenses will have an income for tax credit purposes of £225, rather than £275. Furthermore, the lower a person's income, the higher their tax credits award will be:

- Basic element £1,940 plus 30 hour element of £800 = Maximum Tax Credits award £2,740
- Income £11,700 (disregard £6,420) – 41% taper = £2,164
- Tax credits award = £11.06 a week

However, the award would be nil if he was not in an umbrella scheme.

Whether a worker is working through standard agency arrangements or an umbrella scheme to get to their workplaces, travel expenses will still be being incurred. The purpose of tax credits is to subsidise low pay and provide people with some sort of living wage and assistance with living costs. There is an argument that unavoidable travel expenses, such as the ones incurred by agency workers, should be taken into the account in the award of tax credits in any case. After all, the money spent on getting to work is not available for use in any other way.

Tax Credit claimants will eventually be migrated across to UC which will replace income-based JSA, income-based employment and support allowance, income support, child tax credit, working tax credit and housing benefit. Ensuring employees pay the correct amount of tax in year is a feature of the RTI PAYE system, which in turn feeds into UC. UC will be calculated on a pay period basis depending on net income levels and hours worked. At the time of writing, it is unclear whether unreimbursed employment expenses will be taken into account as they are for tax credits and if so how that fits with RTI (interestingly because of confusion over whether the word 'disregard'

1 For example, petrol five years ago was 86.6p per litre and is 127.9p today compared to NMW rates of £5.73 and £6.31 earlier this year.

2 The main additional rights to which temporary workers employed on an overarching contract of employment are entitled over those engaged on an agency contract are disciplinary and grievance procedural cover by the ACAS Code of Practice, ongoing employment between assignments – including the payment of a retainer where necessary, statutory notice periods to terminate the contract, unfair dismissal protection rights, redundancy pay after a certain amount of service and family rights – maternity, paternity and adoption leave.

3 The Tax Credits (Definition and Calculation of Income) Regulations says: From the amount of employment income, calculated in accordance with the preceding provisions of this regulation, there shall be deducted the amount of any deduction permitted in [calculating earnings by virtue of any provision of sections [231 to 232,] 336 to 344, or section 346, 347, 351, 352, 362, 363, 367, 368, 370, 371, 373, 374, 376, 377 or 713 of ITEPA].

is meant to mean 'deduct'). However we assume it is intended that the UC treatment will follow the tax credits treatment, meaning the availability of s338 travelling expenses will be important for UC claimants too.

Relief at source

Not only is the travel expense relief conferred by the overarching contract welcomed by low-paid workers in its own right, but so is the mechanism by which it is delivered by PDPD providers (the legality of which is disputed by HMRC) – as we go on to look at below.

Timing and method of tax relief

Without the relief at source mechanism used by the PDPD providers, the worker would have to make a claim to HMRC on an annual basis to recover tax on their expenses by filing form P87 'Tax relief for expenses of employment' (assuming they are capable and well-informed enough to do this). By the employer providing the tax relief adjustment at source, it provides the low-paid worker with a cash flow advantage[1].

Also, as we have previously raised in connection with 'refund organisations'[2], the complexity of the tax rules and HMRC administration (forms and processes) in connection with employment expenses mean that refunds may not be straightforward to claim and often workers pay for help, thus diminishing the value of their refund. We understand that HMRC are currently working on a number of projects to improve employee personal tax services – for example, by developing online products to make engaging with HMRC simpler. PAYE online could perhaps lead to a quick and easy way for employees to claim tax reliefs in the future and while we appreciate that there is some potential here, this does not help workers at this time. Further, some of these workers will be digitally excluded and an online service will not ease their plight.

Whilst tax relief is theoretically available for expenses incurred on an in-year basis via a tax code adjustment[3], the PAYE coding facility for expenses is not known to work well – particularly in the context of many changes of circumstances, which often low-paid employees will have. That is the case even if the taxpayers are aware of the ability to 'code in' expenses in the first place. Additionally, this coding will only be on an estimated basis which can lead to problems in its own right.

We assume that these kind of factors were relevant considerations for the employer who is described in the OTS's second report on its review of expenses and benefits[4], as providing tax relief at source for his employees' Flat Rate Expenses (FREs). We also assume that an agreement had been reached between the employer and 'an officer of Revenue and Customs' under s684 (7A) ITEPA which allows HMRC to use their discretion to permit non-standard methods for operation of the PAYE system.

> '5.31 We also recommend that employers should be allowed to obtain tax relief for their employees through net pay arrangements, i.e. through the payroll.
>
> 5.32 Employers would need to notify employees on the payslip that they have made the adjustment. We spoke to one employer who on encouragement from the unions has set up their payroll so that their employees get a deduction for FREs through the payroll. HMRC have indicated they are investigating this

1 It also reduces the administrative burden for HMRC who instead would have to process the claims at the end of the year; however the taxpayer is probably not to know this.

2 See our report 'The Tax Repayment System and Tax Refund Organisations – a call for action: http://www.litrg.org.uk/reports/2013/Refund_Company_Report

3 Under s685 ITEPA 2003 'provisional deduction for allowances and reliefs'.

4 See the report dated January 2014 https://www.gov.uk/Government/uploads/system/uploads/attachment_data/file/275795/PU1616_OTS_employee_benefits_final_report.pdf

option further. This arrangement would be a natural complement to payrolling, as discussed in Chapter 1.'

It seems then, that the stumbling blocks to a PDPD relief at source model being 'approved' by HMRC are not to do with the tax relief feature *per se*, more perhaps the perceived risk that umbrella businesses will give relief for expenses that are not genuine and – of course – the NIC deduction.

NIC relief

In addition to tax relief, PDPD model operators are applying both tax and class 1 primary and secondary NIC relief at source by calculating PAYE on a lower amount of salary. The resulting 12% (primary contributions) saving on their genuinely incurred expenses will no doubt be of great benefit to the worker; however, as we have seen, HMRC have stated that they believe there is no mechanism in the law to support this treatment (see Appendices 5 and 6 to this report).

The commonly accepted view is that the legislation does not currently provide for a deduction from the amount of that employee's earnings where the employee meets the travelling expenses. This means that an employee who is reimbursed qualifying expenses receives tax and NIC relief, but an employee who bears the cost of his own qualifying expenses gets tax relief only (and usually has to make a claim to that effect to HMRC).

To many, this state of affairs is unfair. Interestingly, the statement below appears in the OTS's second report on benefits and expenses[1] under the heading of 'Aligning the definitions and rules for NICs and income tax':

> '7.5 We recommend that a review of the underlying rules is undertaken with a view to aligning the rules as far as possible. If there are to be differences, these should be clear and well known (for example pension contributions might remain income tax deductible but not deductible for NICS to reflect NICs not being charged on pensions). To the extent that separate and different rules are kept (for example pensions) this should be as a result of clear policy decisions.
>
> 7.6 Ideally the deductions which employees are entitled to themselves should also match. However, this is a more radical change to the NICs system as employees could then be entitled to repayment of NICs whilst employers would have no knowledge to obtain a repayment of their contributions. It is recognised that this is probably a step for a later stage of integration of the two systems.'

While this does appear to reinforce HMRC's view that the PDPD model which is claiming NIC relief through the payroll by reference to employee-incurred expenses is not permitted within the current law, it also acknowledges the plight of those who are not reimbursed expenses by their employers and suggests the anomaly should be removed. It could be the case then that HMRC's current view is transitory and that as tax and NIC become more aligned, HMRC may not attach such an intrinsic importance to tackling the giving of NIC relief at source.

The sting in the tail

As we have seen, there are a number of complicated reasons behind a worker being in a PDPD scheme, some of which may be to do with the perceived financial benefits.

However, it is important to note that the tax credit award, tax relief and NIC relief added together still only goes part of the way to restoring the worker's out of pocket position through incurring the expense in the first place – particularly when considering that the workers will have paid fees to the umbrella company to participate in the scheme. In addition, the 'tax relief' may only be fleeting (even where the overarching employment arrangements are watertight and the expenses are genuinely incurred). This is because, even in this period of 'limbo' where

1 Ibid

HMRC have not definitively clarified their position on PDPD nor appear to be preventing workers getting caught up in them, the payroll data that is being submitted by the employers causes automatic tax underpayment calculations to be generated for the workers.

We explain this further below and give several examples of cases that we have seen. Whilst we do not know how many workers are affected, we have shown that PDPD operators are still very much in existence and so suppose the numbers could be in the thousands.

Incorrect data

Our research has not been able to uncover what payroll data scheme providers are transmitting to HMRC, as those transactions are private to employers and HMRC, but it seems to us there could be a mismatch between what PDPD scheme providers are doing and what must be reported to HMRC (which could also affect the employees' tax credit claims as since April 2014, HMRC have been using RTI data to help finalise awards).

In our view, the scheme provider has two choices:

1) To report the lower 'taxable' income amount after taking into account the relief applied through the payroll for travel expenses, which would then match the tax deductions taken from the employee (and perhaps submitting the 'expense' details to HMRC on a P11D separately), or

2) To submit the total income figures before allowing for the employee's expenses, but this would cause a mismatch with amount of tax deducted.

As hours of work now have to be submitted as part of RTI data, reporting the lower 'taxable' income amount (i.e. the amount after expenses have been deducted – option 1 above) should almost certainly flag a NMW error as compared to hours worked. Saying this, we understand that currently HMRC do not analyse the RTI data routinely for the purposes of checking NMW compliance, although we assume (and certainly hope) this will change as RTI beds in – it could be a particularly useful exercise, not least in response to the increasing evidence of NMW compliance failures[1].

The second option above will show up when HMRC do their annual reconciliation of earnings – now an automated process for those whose income is reported under PAYE (where, if you have not paid the right amount of tax, you will receive a P800 Tax Calculation telling you what HMRC consider the correct amount to be and whether you have paid too much or too little). We have certainly seen a very clear example of this in respect of the tax year 2012/13 in the following P800 calculation and year end payslip provided to us by TaxAid:

> HMRC's systems issue a 2012/13 P800 calculation to a worker telling him that he has an underpayment of £949.66. His gross income was £13,775 with tax paid of £184.34, which is clearly too little on that level of income.
>
> Looking at the worker's last payslip, we can see that he seems to have been in a PDPD scheme:

1 https://www.gov.uk/Government/news/hmrc-secures-record-46m-minimum-wage-arrears-for-underpaid-workers

Payslip				**Date 05/04/2013**	
Employee Payments	Hours	Rate	Amount	Employee Deductions	
Salary	30	£6.50	£195	Tax	£0.60
Salary	15	£9.75	£146.25	Employee NIC	£1.55
			£341.25		£2.12
Taxable			£158.89		
Expenses			£150.00		
Non-Taxable			£182.36[1]		
YTD Taxable Pay			£13,775.68	Net Pay	**£306.74**
YTD Tax Paid			£184.35		

(It is worth saying, in light of the 2013/14 payslips that we have looked at in this report, that TaxAid expect to see some P800s for 2013/14, but do not expect them to start filtering through until early 2015.)

The annual reconciliation process also aggregates P11D details with pay and earnings, so underpayment situations will occur when employers have reported the 'net' pay and tax through payroll, but then submit the amount of expenses they have granted tax relief to on a P11D – as these will generate a further tax liability.

Assuming the expenses amounts that are causing the underpayment are allowable and *bona fide*, a P87 (Tax relief for expenses of employment) claim would be possible to negate such a tax charge. It is plausible that some PDPD employers who take the welfare of their employees seriously may be stapling a P87 claim to a P11D form on behalf of an employee so that HMRC can essentially cancel out the tax charge on the employee before it arises. But anecdotal evidence suggests that some such employers are not even providing to the employee a copy of the P11D that has been submitted to HMRC, so we can assume this will not always be the case.

If the workers are able to work out from the P800 calculation why the underpayment has arisen (we must remember however that they may have had no inkling that anything was wrong until they suddenly received the P800) they may be able to reduce their tax bills themselves, by submitting a P87 claim for actual expenses incurred 'wholly, exclusive and necessarily'. However, the form asks for *details* about the expenses as well as 'how you worked out the amount you want to claim' and the workers may lack ability and confidence to complete the form. In any case, not realising their importance or having given them to the PDPD provider, the workers may not have all the receipts to justify a claim to HMRC's satisfaction. Further, HMRC are currently trialling an 'interactive' P87 which must be completed on-screen rather than on paper and there are a number of limitations with the form which may mean that the workers cannot use it even if they were otherwise able to.[2]

Usually the workers do not know which way to turn and ultimately, fearful of the consequences of not doing so, will likely just pay the bill (or be forced to come to an arrangement with HMRC to pay it). As typically these schemes are marketed to the lowest-paid workers, it is those who are least able to settle the tax liability who will find themselves in this position. In addition, on the basis that a fee will have been deducted already by the PDPD provider before transmitting the balance of the relief given at source to the individual, the HMRC debt may be significantly greater than any financial benefit he received in the first place.

1 This number implies that the fee paid by the employee was £32.36.

2 We explain some of the problems here: http://www.litrg.org.uk/News/2014/tax-relief-for-employment-expenses-online-claims

8. How to improve the positions of low-paid agency workers

The OTS's work on employee benefits and expenses has highlighted to Government that there are issues with the tax rules on travel and subsistence expenses in that they are not simple to understand and use, nor have they kept pace with changes in working practices. In response, the Government has launched a review into travel and subsistence, which will be conducted in stages. The current stage (Stage 1) is focussed on scoping the framework for travel and subsistence expenses (e.g. what sort of payments should qualify for tax relief, by whom they should be paid, to whom and how they should be paid); with the purpose of Stage 2 – which we understand may run until 2017[1], being to produce a new set of principles upon which the rules of a new travel and subsistence regime can be based.

This review is to be welcomed as it provides the opportunity for some changes to the underlying fault lines in law that drive workers to use PDPD models in the first place. However these changes are likely to be a long time coming and if HMRC's position on PDPD has not changed in respect of how they see PDPD under the current law, it cannot be right that things are being allowed to 'drift on' at employer level, yet in the meantime workers are receiving P800 calculations for underpaid tax. While there are provisions in the PAYE Regulations 2003[2] which allow HMRC to demand missing tax from either the employer or the employee (as explained below), in our view HMRC have a duty to tackle the employers first – not least because it is the equitable thing to do, but because it is the correct thing to do under law.

PAYE underpayments

As we have discussed in the previous chapter, a worker in a PDPD scheme may receive a P800 calculation showing an underpayment where 1) the 'gross' pay and tax has been declared through the payroll or 2) the 'net' pay and tax has been declared through the payroll but a P11D has also been submitted.

The PAYE Regulations say that HMRC can collect tax underpayments from the employer under Regulation 80 – this is effectively a means of enforcing the payment of PAYE and says that the employer will remain liable for the tax that should previously have been accounted for to HMRC but for whatever reason was not paid. (Regulation 80 only applies to the recovery of tax, however there are similar powers for NIC under section 8 of the Social Security Contributions (Transfer of Functions) Act 1999.)

Regulation 72

There is an alternative route open to HMRC to transfer liability to the employee under Regulation 72. However use of Regulation 72 is restricted to cases satisfying either of the two conditions:

1) That the employer took reasonable care to comply with the PAYE regulations and its error was made in good faith; or

2) That the employee had received relevant payments knowing that the employer willfully failed to deduct the amount of tax which should have been deducted from those payments.

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1 See article here http://www.employeebenefits.co.uk/compliance/ots-benefits-simplification-reforms-not-likely-until-2017/105581.article

2 http://www.legislation.gov.uk/uksi/2003/2682/contents/made

The wording of Regulations 72 and 80 are reproduced as Appendix 7.

Based on HMRC's view of the law, PDPD operators are operating the PAYE scheme incorrectly, and with even just a preliminary investigation of the payroll data submitted to HMRC via RTI, we think it would be very clear that the employer had not made an 'honest mistake' in order that the first condition could apply. With respect to the second condition, HMRC may well say the employee knew the employer had wilfully (that is deliberately) failed to deduct the correct amount of PAYE from their earnings – pointing perhaps to possession of the worker's contract and payslips as proof they knew what was going on. However as we have shown in the previous chapter, it is not always easy to 'blame' an employee for being in a PDPD scheme. Often the background to their involvement is much more complex.

Whether Regulation 72 applies or not, HMRC should not issue a tax calculation without at least checking their records for signs of whether an employer has operated the PAYE system properly. Indeed, HMRC's own internal guidance requires them to look first for employer error and it is worth quoting the following passages:

> PAYE90020 – Reconcile individual: underpayments: PAYE directions
>
> 'If an employer fails to deduct the correct amount of PAYE from an employee's earnings, the employer is liable for the amount under-deducted. The underpayment should be recovered from the employer not the taxpayer, unless HMRC makes a PAYE direction.'
>
> PAYE92066 – Reconcile individual: posting EOY information to individual records: under-deductions
>
> 'Under-deductions of PAYE tax should always be requested from the employer in the first instance.'

Pursuit of employees for under-deduction by employers

Notwithstanding this, more often than not HMRC issue P800s straight to the employee with no preliminary investigation as to the cause of the underpayment. Whilst HMRC's website does tell workers who have received a questionable P800 underpayment calculation to write to them and tell them why they think their employer has not deducted enough tax (because 'they may be due to pay back the tax owed instead of you'), this seems to be the wrong approach. Workers might not have the ability or wherewithal to do this – or understand the detail enough to explain what might have gone wrong. This must surely be one of the reasons that the law made the employer the default party for the underpayment in the first place.

Besides, the Regulations provide for a right of appeal for the employee against a Regulation 72 direction notice, so if HMRC pursue the employee without first trying to engage with the employer, and dispense with the official direction notice as often happens, they are effectively depriving the employee of the right of appeal which their own Regulations confer upon him.

To make matters worse, even if a worker does prompt HMRC to look for 'employer error', he may not find a sympathetic ear – HMRC still do not have a good track record when it comes to asking employers why they failed to follow proper instructions to deduct PAYE tax.[1] Indeed in a recent case,[2] the First Tier Tax Tribunal allowed a taxpayer's appeal against an HMRC 'direction notice' under PAYE Regulations concerning unpaid income tax, ruling that the taxpayer's employer did not take reasonable care. They seemed to take rather a dim view of HMRC simply accepting the arguments from the employer about reasonable care being taken and seeking instead to assess the taxpayer. Often a tax charity like TaxAid may pick up the worker's case and try to appeal to HMRC to agree not to

1 As discussed in the article 'ESC A19 and Regulation 72 – where are we now?' http://www.tax.org.uk/Resources/CIOT/Documents/2013/06/130601TaxAdviser.pdf

2 *Sparrey v HMRC* [2014] UKFTT 823 (TC).

pursue the employee. However even for experienced tax professionals like those working at TaxAid, getting HMRC to take this course of action is usually only successful after some very protracted correspondence.

In essence, we are at a loss to explain why HMRC so often act directly contrary to their own Regulations, pursuing the employee rather than the employer – not least because administratively it must be far less easy to chase large numbers of employees rather than just deal with the single employer. To add to the confusion, in relation to underpaid class 1 NIC, HMRC do not seem to be requiring employees to make good under-deductions even though the social security legislation is similar to Regulation 72 of the PAYE Regulations[1]. HMRC's efforts are therefore not only ill-targeted but seem piecemeal and inefficient.

Perhaps there has been no 'decision' at all in terms of how to approach PDPD, and the situation is just a product of a dysfunctional lack of communication internally or poorly coordinated departments. Or perhaps it is because HMRC fear there is a risk that the umbrella company may just go bust at the first sign of trouble. Whatever the reason, it is unacceptable for HMRC to not at least attempt to challenge the employer and instead pursue liabilities from employees who will generally be less able to defend themselves.

We therefore urge HMRC to adhere to their own Regulations by pursuing the employer for under-deducted PAYE tax rather than the employee. They could do this by scrutinising any information that the employer compliance team have about PDPD, analysing their RTI data for the corresponding employer references, and manually reviewing the data in their underpayment system that sits under those employer references. If HMRC really do not have any intelligence about PDPD within their employer compliance team, then HMRC compliance teams need to build on the work we have done in this report, researching PDPD scheme providers and raising PAYE compliance checks into them to investigate their practices.

Determination

There has been an explosion of comment from Government in recent years around tax avoidance and everybody 'paying their fair share'. HMRC have a vast array of new weapons in their tax avoidance arsenal, including the General Anti Abuse Rule (GAAR) to help them make sure that this happens[2].

HMRC's stated view is that PDPD is 'not-compliant', yet they seem to be taking a lenient approach with the PDPD providers at employer level and allowing the confusion and ambiguity over the schemes to carry on. No doubt there are some variations on the theme in the market place, but it seems to us that the standard PDPD arrangements are not particularly obfuscatory or contrived, therefore it should be straightforward for HMRC to build a case against a PDPD provider so that the matter could be settled once and for all.

The obvious option must be for HMRC to issue a Regulation 80 determination against a provider – not only the mechanism to collect underpaid tax as discussed earlier, but as there is a right of appeal, it can be used as a vehicle to take contentious points to the First Tier Tribunal – a setting in which decisions on complex tax argument will have persuasive force.

There will be two possible results:

- The Tribunal upholds the appeal and rejects the determination. The Regulation 80 tax will be discharged.
- The Tribunal confirms the determination. The employer must pay the Regulation 80 tax.

We appreciate that court cases themselves are time-consuming and costly but if HMRC believe the schemes to be

1 Social Security Administration Act 1992, s 121.

2 See http://www.hmrc.gov.uk/avoidance/overview.htm

non-compliant, they have an obligation to pursue them, in order to build the deterrent effect and to demonstrate visibly to those who are compliant that the Government is taking action.

A Regulation 80 decision against PDPD in the Tax Tribunal would no doubt reverberate across the industry. However, it should be remembered that this may well have the consequence of low-paid workers finding themselves back on traditional agency contracts – without an immediate tax and NIC saving, umbrella companies would not find it profitable to offer overarching contracts to low-paid workers.

Sustainability

'Travel and subsistence' solutions are often driven by the needs of the low-paid. With their 'need' still in the market and our complex law providing countless opportunities to exploit, it seems likely that another solution will just step into the void and often, these are worse than the ones they seek to replace. The progression from IR35 to MSCs illustrates this, not to mention the subsequent evolution from umbrella companies to PDPD and so on.

Indeed, we can perhaps see a glimmer of the 'next big thing' for low-paid agency workers; in a response that our fictitious 'Paul' (from our research exercise) received from one umbrella company below:

> 'By joining all our other Consultants…you too could benefit from an increased weekly income!
>
> You agree to become a Director of one of our Mini umbrella companies and enjoy the benefits that brings. Each week you can claim for all of the necessary expenses you incur when completing any assignment you are working on.'

Whilst we have not looked into the inner workings of this 'scheme', it sounds like something the existing intermediary legislation, MSC or IR35, might be able to counter. However this brings us to the important point that that the behaviour of some businesses in the offshore/onshore, employment/self-employment, managed service companies/personal service companies, umbrella/agency arena has likely been exacerbated by HMRC not having a sufficiently well-resourced compliance function to fully explore 'schemes'. Unless this changes, new schemes will always be coming to market.

Indeed Lord Simon of Glaisdale shone a light on the mind-set of scheme providers all the way back in 1974 in *Ransom v Higgs*[1] when he said:

> '….and since the burden of taxation is heavy (in some circumstances punitive), and since there is generally some delay before tax avoidance schemes come to light (during which time a rich windfall may be garnered), there is a strong incentive for such experts to devote their talents to devising tax avoidance schemes for clients….and for such clients to adopt the schemes devised…'

These days of course, we have the Disclosure of Tax Avoidance Schemes (DOTAS) regime and all sorts of other legislative pre-emption, so new schemes may be short-lived. However it must be recognised that such pre-emptive legislation itself may create new avoidance opportunities by providing a 'road map' for scheme promoters, defining what is not subject to the rules as well as what is.

A good example of this is the rise of the Elective Deductions Model – a scheme created to exploit the 'weaknesses' in the new rules on false self-employment[2]. This is despite comments in the Onshore Employment Intermediaries: False Self-employment – Summary of Responses (published 13 March 2014) that the Government 'is aware that certain elements in the temporary labour market are quick to react to any legislative changes and to find

1 *Ransom v Higgs* [1974] 3 All ER 949.

2 Explained here: http://www.litrg.org.uk/News/2014/sch-circum-new-false-selfemp-rules-already-appear

new vehicles to reduce income tax and NIC and that the Government intend to introduce a TAAR (targeted anti-avoidance rule) in the legislation to deter such avoidance'.

Ultimately, this conflict between HMRC and promoters could go on *ad infinitum* and we therefore consider there is a better way forward – and that is to eliminate the underlying problems in the original legislation. This would remove the incentive for such schemes from the market place altogether – thus producing the desirable 'level playing field' and saving considerable effort all round.

A possible way forward

It seems to us that one way of helping to solve the ongoing issues with travel costs- on an enduring basis- is by changing the law on travel expenses relief to allow low-paid agency workers to treat their assignment locations as temporary workplaces rather than fixed term appointments. There are other pieces of legislation that apply to 'Employment Businesses'[1], meaning that workers in such businesses should be simple to define. 'Low-paid' might be more difficult to carve out, however this concept is being looked at in respect of protecting low-paid non-resident workers from the possible removal of the personal allowance[2], so should not be an insurmountable problem. This would make the requirement for an overarching contract redundant and means a worker would not have to pay a fee to an umbrella company for this 'service'.

However we recognise that such a move would do little to assist other low paid workers- 'portfolio' workers for example, who may have two or three part-time employments (morning/evening shifts as cleaners, perhaps with weekend work as well)- none of these are temporary workplaces, yet the burden of travel to work costs are not dissimilar to agency workers. In addition there would still be the lack of balance in the system for those who do not have their expenses paid or reimbursed by their employer to tackle, in terms of the unfair class 1 NIC anomaly that currently prevents workers from claiming a NIC refund as well as a tax refund.

We acknowledge that such a change would not offer a complete solution, therefore it is not a cut-and-dried recommendation. What we hope though, is that it (and this report more broadly) will provide the starting point for more detailed discussions between government, employer and employee representatives as part of the Travel and Subsistence review, as to what the new set of rules that reflect modern working patterns should look like. We are conscious of and would like to commend the OTS's substantial efforts in this area leading up to this review which seems to us to present a real opportunity to truly make a difference for low-paid employees.

We conclude this chapter by providing a summary of our recommendations for improving the position of low-paid agency workers:

In the short term:

- HMRC to stop pursuing the PDPD employees for under-deducted PAYE tax instead of the employers.
- HMRC should issue a challenge in the form of a Regulation 80 determination which, if appealed, will enable the legality of the PDPD model to be established once and for all in the tax tribunal; at present there is a lack of clarity which can only result in further problems for low-paid workers- whether they are receiving P800 calculations or not.

1 For example The Conduct of Employment Agencies and Employment Businesses Regulations 2003.

2 See the consultation document here: https://www.gov.uk/government/consultations/restricting-non-residents-entitlement-to-the-uk-personal-allowance

In the longer term:

- The law on travel expenses relief should be changed for low paid workers.
- Remove the unfair class 1 NIC anomaly so that workers can claim a NIC refund as well as a tax refund (however our comments on difficulties for workers in accessing income tax refunds are likely to be pertinent here too in the absence of any changes to the reclaim process and/or introduction of voluntary payrolling).

In addition, as alluded to in other parts of this report, we would like to see:

- HMRC providing better information to agency workers about their employment and tax positions – tailored to them and potentially made available through more than one channel.
- Workers not being sanctioned by DWP for refusing agency work where a 'scheme' is involved.
- Jobcentre Plus staff encouraged to use their discretion to help with the costs for the first months of travelling to work under the flexible support fund.
- HM Treasury starting to explore the implications of extending the NMW to cover unreimbursed s338 travel expenses.

9. Conclusion

We hope that the immediate outcome of this report will be that HMRC will cease pursuing workers in PDPD schemes for underpayments and instead issue Regulation 80 determinations against PDPD providers.

This would be both in accordance with Government policy of wanting 'a simpler, fairer tax system that supports those on low and middle incomes while making sure that those who can best afford it make a fair contribution'[1] and HMRC's Your Charter aim of 'giving you a service that is even-handed, accurate and based on mutual trust and respect'[2].

Yet, arguably, all PDPD has done is highlight how deficient the underlying rules are – and these have been within the Government's own hands to correct for a long time. Indeed, it was back in 1953 that a judge in one of the leading cases on the tax deductibility of expenses *Lomax V Newton*[3] described the employee expense rules as '….notoriously rigid, narrow and restricted in their operation'. They were also described in that same case as 'to some extent unfair'. This is nowhere more evident than in the case of travel expenses, where over the years, LITRG has pressed for improvements to the arcane rules, but to no avail.

We hope that the Travel and Subsistence consultation presents a real opportunity for change. However if the Government cannot move with the times then it will have to accept that there will always be a market for the kinds of arrangements discussed in this report and that the market can only be expected to grow as the cost of travel to pay ratio increases. At the same time, their track record on dealing with these schemes has been inefficient – indeed, ever since IR35 (itself now regarded as 'clumsy'[4]), there seem to have been a long series of ill thought out reforms in the 'contractor' area, which have fixed one problem only to create another. Sadly, it seems unlikely to improve due to the inherent problems of countering schemes on a case-by-case basis and in the meantime, low-paid and unsuspecting workers will continue to be caught up in the ensuing mess.

In our view, the time has come for the Government to act decisively and put tax (and NIC) relief for travel expenses for low-paid workers on its right and proper footing by amending the original legislation. Such a move would bring with it simplicity, certainty and fairness – and must surely be where the long term, best protection for low-paid workers lies.

1 See https://www.gov.uk/Government/policies/creating-a-simpler-fairer-tax-system

2 See https://www.gov.uk/Government/uploads/system/uploads/attachment_data/file/91888/charter.pdf

3 *Lomax v Newton* 34 TC 558.

4 See chapter 2, Select Committee Report on Personal Service Companies: http://www.parliament.uk/business/committees/committees-a-z/lords-select/personal-service-companies/

Appendix 1 – Background to the evolution of umbrella companies

In his 1999 pre-budget speech, the then Chancellor of the Exchequer Gordon Brown MP spoke about avoidance of the employment relationship using intermediaries: the mischief he shone a light on being that an individual could avoid being taxed as an employee and paying Class 1 NIC by providing his services through a company (there can never be an employer-employee relationship between two companies). Often however, when applying the 'IR56 tests'[1] to the nature of the relationship between the worker and the end client, it would have been one of employer – employee, but for the intermediary.

He had a particular type of intermediary in his sights, a **personal service company** (PSC). A PSC involved an individual selling their services to an end client through the medium of a limited company. The individual was a director, shareholder and employee of the company. Typically, an individual paid himself a small salary at or around a level which saw his rights to state benefits protected but tax and NIC liabilities minimised (in 2014/15 for example, this is £111).[2]

The rest of the remuneration was then paid in a combination of dividends (which do not attract a NIC charge and carry a 10% tax credit which extinguishes the liability for a basic rate taxpayer) and tax free reimbursed travel expenses. The latter element arose because the individual was considered to be an employee of his own company, not an employee of the end client: where an individual was continuously employed by his PSC and undertook contracts for clients of the PSC in different places, the client's premises could be treated as a temporary place of work. This meant that tax relief was available for his travel (along with associated subsistence and accommodation expenses). The individual worker concerned would incur the travel expense; receive reimbursement from the service company and, in turn, the service company would then set against its taxable profits.

Clearly, people working through PSCs would overall be paying substantially less tax or NIC than a person who is employed by the end client direct. This is because all of the directly hired employee's remuneration was subject to tax and NIC via the PAYE system and their travel expenses were considered ordinary commuting to a permanent workplace, therefore were not allowable. Cue the IR35 legislation (as it came to be known) which ensured that if the relationship between the worker and the client would have been one of employment had it not been for the intermediary, the worker (after undertaking a somewhat convoluted calculation and lots of administration) would broadly pay tax and NICs commensurate with what an employee of the client would have paid. It is important to note at this stage that IR35 only applied where the worker owned more than 5% of the shares in the intermediary company.

In order to avoid the 5% shareholding threshold, **Managed Service Companies** (MSCs) came along, offering similar advantages to working through a PSC but run by an outside business that managed and controlled the company, dealing with all the company and tax administration – meaning a hassle-free alternative to running a PSC. Mainly the workers would be in a composite company – made up of many, generally unconnected (apart from perhaps being in the same type of trade), non-director shareholders, each holding different classes of share allowing the appropriate amount of income to be channelled to them via a dividend.

Many contractors would not be caught by IR35 as they would not own more than 5% of the shares in the MSC.

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1 IR56 now replaced by ES/FS1 – a booklet Employed or self-employed for tax and NIC.

2 Employees do not have to pay NIC on the first £153 a week, yet those with earnings between £111 and £153 a week, are deemed to have paid NIC (in 2014/15).

However, in some cases IR35 did theoretically apply. Notwithstanding that invariably MSC workers were not in business on their own account and the underlying nature of their contracts with end clients would otherwise be one of employment, IR35 was unsuccessful in addressing the problem of MSCs due to the resource intensive investigation required for enforcement. There would often be many workers in each MSC and there were a large volume of MSCs. Status Inspectors within HMRC had to determine employment status on a case-by-case basis. Also, they had no basis under the IR35 rules or otherwise to recover the tax from the providers of the MSCs. Therefore some alternative legislation to counter the exploitation by MSCs was introduced in 2007.

The Managed Service Company legislation[1] required MSCs to apply PAYE to all income earned by individuals operating through managed service companies by deeming *any* payment or benefit received by a worker through an MSC as earnings from employment subject to NIC and PAYE at time of receipt – regardless of whether there was an employer-employee relationship between the end client and the worker or not. Unlike the deemed IR35 calculation which continued to treat the worker as an employee of its own company allowing temporary workplace travel expenses to be taken into account, the MSC deemed payment could only be reduced by the expenses that would have been deductible had the individual been employed directly by the client – this would not include travel expenses to and from work as it would have been their permanent workplace. There were also some controversial debt transfer provisions to connected parties to the MSC in the event that that HMRC liabilities were not paid.

Umbrella companies were largely born from the MSC legislation in 2007. An umbrella company provides contractors that might have used a service company previously with a continuous contract of employment, which then turns the end client sites they are 'assigned' to into temporary workplaces (as an employee of the umbrella company, there is no risk of them being caught as disguised employees of the end client). The cost of travel to those workplaces is therefore allowable against tax. To be clear: all of an umbrella company's contractors are employed by a single limited company. They are not directors of it and receive no income in the form of dividends. All remuneration is taxed at source under PAYE and therefore there is no need to worry about calculating deemed payments.

In addition, by using an umbrella company, one of the main advantages of operating through a service company (the ability to claim travel expenses) is therefore restored. Such a state of affairs is often enhanced by the 'employer' umbrella company obtaining a detailed P11D dispensation so that employees of umbrella companies can be paid tax and NIC free travel expenses to and from their temporary workplaces. Umbrella companies therefore typically paid lower wages and made up net pay with (sometimes inflated) tax-free expenses, saving tax and NIC (both employee and employer) – the umbrella company then taking part of this saving as its fee.

1 http://webarchive.nationalarchives.gov.uk/20100708170320/hmrc.gov.uk/employment-status/legislation.htm

Appendix 2 – Explanation of umbrella arrangements and associated law

The five elements that facilitate the traditional umbrella arrangement are as follows:

Continuous contracts of employment

A continuous (or overarching) employment contract allows temporary workers to link a series of separate engagements into a single ongoing employment with the umbrella company. Consequently, the umbrella company is able to treat each engagement as a temporary place of work and use the temporary workplace rules.

The umbrella contract should have all the features of a normal employment contract. From case law, principally *Ready Mixed Concrete (South East) Ltd v. Minister of Pensions and National Insurance* (1968)[1], this means:

i) 'The servant agrees that, in consideration of a wage or other remuneration, he will provide his own work and skill in the performance of some service for his master.

ii) He agrees, expressly or impliedly, that in the performance of that service he will be subject to the other's control in a sufficient degree to make that other master.

iii) The other provisions of the contract are consistent with its being a contract of service (i.e. it grants the full employment rights and statutory protections).'

Mutuality of obligation is a key component of any employment relationship. The worker agreeing to provide their skill and the employer agreeing to pay for that skill is what is referred to as 'mutuality of obligation' (i.e. bullet point (i) above).

In order for a contract to be considered overarching, there must be mutuality of obligation over the duration of the employment, even in the gaps between assignments[2]. To demonstrate their continuous nature, typically an overarching employment contract will offer a minimum work guarantee – for at least 336 minimum guaranteed hours per year[3], though HMRC guidance does not rule out the possibility of a zero-hour contract also being an overarching contract depending on its exact terms[4]. A minimum of 336 hours represents a notional one working day per week (for 48 weeks, assuming four weeks of holiday) – essentially akin to the employer paying a retainer of seven hours in any weeks when there is no work to be done. In return, the employee is obliged to accept offers of work from the agency. They may be asked to do things like their 'paperwork' or research for new assignments and so on if no work can be found.

Holiday entitlement must be calculated on the basis that the employment is continuous and not on an assignment-

1 Citation 2QB497.

2 See HMRC Manuals, ESM2080: http://www.hmrc.gov.uk/manuals/esmmanual/esm2080.htm

3 See HMRC Manuals, ESM2087: http://www.hmrc.gov.uk/manuals/esmmanual/esm2087.htm

4 See HMRC Manuals, ESM2090: http://www.hmrc.gov.uk/manuals/esmmanual/esm2090.htm

by-assignment basis[1].

Following the decision of an Employment Tribunal on 4th October 2013 in *Thompson & 5 others v Paymaster Ltd (t/a Back Office)*[2], it is also important that the umbrella company be regarded as the true employer of the workers – this means they have to have more than minimal engagement with the worker. In order for there to be an employment, there must be a sufficient degree of control exercised over the worker by the employer (bullet point (ii) above). Where a worker works for an end client, it is difficult for any umbrella company to legitimately claim that they have 'control' over any of their employees' working practices – control in agency worker cases is often ceded to the end user. So typically, they ensure that control is exercised in other ways – for example: providing an assignment schedule giving details of the client, work location, start dates and end dates, job specifications, training requirements, maximum and minimum working hours and assignment rate. In this case, no control took place – Paymaster was essentially a silent partner. In addition, the agencies gave the workers no choice in working with Paymaster which was also considered to be indicative of control on the part of the agencies rather than by the umbrella company. As such, the judge decided that – despite the contract of employment – the umbrella company did not exert control over the workers and therefore they could not be termed employees (nor even workers) of Paymaster.

Finally, following *Autoclenz Ltd v Belcher & Others (2009)*[3] the contracts put in place by umbrella companies with their employees must reflect what happens in reality.

Temporary workplace

The principle of allowing tax relief for travel costs that are incurred as part of an employee's work is well-established, the legislation now being found within Part 5, Chapter 2 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003).

Under general principles, a deduction for the employee's travel costs are allowable for tax purposes if:

- they are necessarily incurred on travelling in the performance of duties of the employment[4]; or
- attributable to the employee's necessary attendance at any place in the performance of the duties of employment.

Section 338 ITEPA 2003 specifically denies a deduction for 'expenses of ordinary commuting' – that is, travel between the employee's home and a permanent workplace.

Most employees have a fixed workplace where they work for the majority of their time. These rules therefore mean that there is no tax relief available to them for travel costs in getting to their permanent workplace. This is the case even where it is their workplace for only a short period of time.

However, once at work, they may also be required to make trips to other locations – this travel in the performance of duties is allowable. But what if the employee travels directly from his home to other locations? These costs are

1 See HMRC Manuals, ESM2097: http://www.hmrc.gov.uk/manuals/esmmanual/esm2097.htm

2 Case number 1301594/2013.

3 Citation UKSC 41 – see also HMRC Manuals ESM7310 – http://www.hmrc.gov.uk/manuals/esmmanual/esm7310.htm

4 Employees such as commercial travellers, or service engineers, qualify for relief under the 'in the performance of the duties' rule – they are actually employed to travel as part of their duties.

allowable provided that the location only constitutes a temporary workplace[1].

A temporary workplace is defined in section 339 ITEPA 2003 as a place which the employee attends in the performance of his duties in order to perform a task of limited duration or for some other temporary purpose. A workplace will not be 'temporary' if the employee attends for a period of continuous work lasting more than 24 months. A period of continuous work is a period over which the duties of the employment are performed to a significant extent at that workplace. HMRC interpret 'significant extent as meaning more than 40% of the individual's working time'.[2]

As alluded to above, the temporary workplace rules are relatively new – prior to 6 April 1998 most workers were allowed to claim tax relief for travel only from their usual workplace to a temporary workplace. The rule which allows workers access to tax relief for travel and subsistence expenses for travel between their home and a temporary workplace was therefore a considerable relaxation.

Expenses

Where sections 337 and 338 ITEPA 2003 apply, tax relief becomes available for the employee's travel expenses including the cost of travel, subsistence (food and drink) and accommodation (where there is an overnight stay).

The main rules that apply where an employer reimburses travel expenses are below:

Travel costs

The employee may incur rail, bus, and other transport charges. Where the employer chooses to reimburse an employee for these, then unless there is a dispensation (see later) the amount should be reported on form P11D, which is the employer's annual return of expenses and benefits provided. The employee will then need to claim tax relief on the expenses – they can submit form P87 to HMRC[3].

Mileage payments

There is a statutory system of tax-relievable approved mileage allowance for business journeys in an employee's own transport.[4] Where the employer pays mileage allowance, relief may be obtained for amounts paid in accordance with the statutory rates of mileage reimbursement. Provided there is no profit element (i.e. no excess is paid), they are not subject to PAYE or NIC and do not need to be reported on form P11D.

Vehicle	Mileage in tax year	Rate per mile
Cars and Vans	Up to 10,000 miles	45p
	Excess over 10,000 miles	25p
Motorcycles	No restriction	24p
Bicycles	No restriction	20p

If an employee does not receive full reimbursement in accordance with the rates above, or is not paid for business mileage at all, they can claim tax relief on the difference.

1 See HMRC Manuals, EIM32360 and 32366 – http://www.hmrc.gov.uk/manuals/eimanual/EIM32360.htm and http://www.hmrc.gov.uk/manuals/eimanual/eim32366.htm

2 See HMRC Manuals, EIM32080 – http://www.hmrc.gov.uk/manuals/eimanual/eim32080.htm

3 See http://search2.hmrc.gov.uk/kb5/hmrc/forms/view.page?record=lNKqI3HRKkQ

4 Under s229 to s236 ITEPA 2003.

For example, Jack is a basic rate taxpayer. In 2014/15, he drives 1,000 business miles in his own car. His employer reimburses him at 35p per mile, i.e. £350. But Jack is entitled to tax relief on 1,000 miles at 45p per mile, i.e. £450. A common misconception is that the £100 difference can be claimed from HMRC, but in fact it is only tax relief on the difference that is due. Jack can therefore submit form P87 to HMRC claiming tax relief at 20% on the £100 difference, i.e. £20.

It should be noted that employers are also able to pay employees a 'passenger payment' in addition to the authorised rates, up to 5p per mile for each additional passenger they carry[1]. But if the employer does not make such payments, the employee cannot claim tax relief for carrying passengers.

Accommodation and Subsistence

Accommodation and subsistence expenses can be reimbursed on the basis of actual costs. Unless there is a dispensation (see later), the amounts should be reported on form P11D.

However, subsistence is an example of an expense that employers often choose to reimburse by means of a scale rate payment rather than by reimbursing the actual expenditure incurred by employees in performing their duties. For example, rather than reimbursing an employee £3.59 for a sandwich and £1.99 for a coffee, to keep things simple they may just pay a round sum amount of £5. Employers are free to come to a specific agreement with HMRC as to the rates[2]. Otherwise HMRC have benchmark scale rates (BSR) which all employers can use. The BSRs are a set of advisory rates which HMRC accept may be paid by an employer because the BSR is likely to relate closely to the actual subsistence expenditure incurred by an employee. In Revenue and Customs Brief 24/09, HMRC stated that the BSRs must only be used under the following qualifying criteria:

- The travel must be in the performance of duties or to a temporary workplace.
- The employee should be absent from his normal place of work for a continuous period in excess of five hours (after ten hours further expenses might be claimed).
- The employee should have incurred a cost on a meal (food and drink) after starting a journey.

The benchmark scale rates that apply from 6 April 2009 are as follows:

Situation	Detail	Rate
Breakfast*	Irregular early starters only	£5
One meal rate	Away for at least five hours	£5
Two meal rate	Away for at least ten hours	£10
Late evening meal rate*	Irregular late finishes only	£15

*The breakfast and late evening meal rates are for use in exceptional circumstances only and are not intended for employees with regular early or late work patterns.[3]

Scale rate payments can be made tax- and NIC-free to an employee without any records having to be kept and without having to report these expenses to HMRC[4]. However there should be some evidence that the employee

1 Sections 233 and 234 ITEPA 2003.

2 Employers are required to show in their dispensation application that they have based their scale rate on a sample of employees' actual expenditure, see for example HMRC Manuals EIM05210 – http://www.hmrc.gov.uk/manuals/eimanual/EIM05210.htm

3 For more information see HMRC's Employment Income Manual at EIM05231.

4 Where the scale rate does not cover actual expenditure, then a claim can be made for the difference by the employee.

incurred some expense, before being paid.

Dispensations (notice of nil liability)

The starting point when thinking about most expense reimbursements[1] is that they should be reported by the employer on the form P11D. This means that they count in the first instance as taxable income on the employee, leaving the employee to have to claim relief if they are eligible for a tax deduction which has the effect of cancelling out the tax that they would have had to pay. This means a lot of unnecessary paperwork. So for convenience, HMRC can issue a 'dispensation' in respect of business expenses that qualify for tax relief which means that they do not need to be included on form P11D. Dispensations are also effective for NIC purposes.

Under s65 ITEPA 2003[2], HMRC have to be 'satisfied' as to various things before granting a dispensation:

- No tax would be payable by the employees on the expenses payments or benefits in question;
- That the employer has satisfactory controls in place, for example that expense claims are independently checked and authorised within the company so that the amount claimed is not excessive or the claim does not include disallowable items;
- Each claim by the employee is submitted with appropriate receipts (where feasible).[3]

Once granted, dispensations last indefinitely. However, HMRC review them regularly (usually at intervals of five years or less) to make sure that the conditions under which they were issued still apply and HMRC can revoke a dispensation if in their opinion there is reason to do so. The dispensation only operates in the circumstances and for the expense categories that the employer notified to HMRC.

Salary sacrifice

In most travel and subsistence schemes examined in this report, the expenses paid to the worker for travelling to a temporary workplace are not paid on top of the worker's salary. Instead, the worker enters into a salary sacrifice arrangement, where he 'sacrifices' part of his 'base' salary, which reduces the amount of pay subject to tax and NICs. The reimbursed travel expenses, which are free of tax and NIC, are then paid to the worker in addition to this reduced pay. It is important to note that the umbrella company will also save employer's NICs on the pay which has been given up and replaced with travel expenses that are tax and NIC free.

Salary sacrifice is a contractual arrangement and 'sacrifice' is achieved by varying the employee's terms and conditions of employment relating to pay. Salary sacrifice is a matter of employment law, not tax law. However HMRC have an interest in determining how the tax and NIC legislation applies to the various elements in the employee's remuneration package. Here a salary sacrifice has been put in place for the purpose of converting cash pay that is subject to tax and class 1 NICs to a benefit that has a different tax/NICs treatment, so HMRC have to be satisfied that the salary sacrifice is effective, because if it is not then the payments sacrificed are still treated as if they had been paid and tax and NIC should apply.

1 Apart from those such as mileage allowance payments, incidental overnight expenses and relocation expenses that are completely exempt provided they do not exceed the relevant statutory limits.

2 http://www.legislation.gov.uk/ukpga/2003/1/section/65

3 The employer must keep records relating to employees' expense claims, even if there is a dispensation in place – see http://www.hmrc.gov.uk/payerti/exb/recordkeeping.htm

HMRC provide a lot of guidance on effective salary sacrifice[1]. It can be noted that where it is effective and it is clear that the worker has made an informed decision, HMRC see nothing wrong with salary sacrifice as a concept and indeed have promoted it in respect of childcare vouchers.

1 http://www.hmrc.gov.uk/specialist/salary_sacrifice.pdf

Appendix 3 – Briefing sheet from scheme promoter

'Low-Paid Workers – Tax Relief Payroll Calculation

Introduction

We are aware of an opportunity for low-paid employees to enjoy the benefits of receiving tax-relief on expenses which are incurred "wholly, exclusively and necessarily" in the performance of their duties of employment without breaching National Minimum Wage (NMW) Regulations, taxes acts or the Social Security Regulations.

Under such an arrangement (which does not involve a salary sacrifice or a "payment" of expenses by the employer), the result is that low-paid employees who incur and meet an expense incurred in the performance of their duties of employment will receive a significant increase in take-home pay. There is also a reduction of National Insurance Contributions (NIC) payable by the employer.

Overview of the Payroll Calculation

Under this arrangement, the employer is allowing employees who incur the cost of qualifying business related expenses to make a claim for tax relief. In our opinion, it is beyond doubt that the taxes acts and Social Security Regulations allow such expenses to be disregarded from Pay As You Earn (PAYE) and NIC's.

It should be stressed that the employer is not making a payment of or a reimbursement of expenses and the gross pay remains to be calculated as the hourly rate (at least the NMW) multiplied by the number of hours worked.

The "relief" is calculated on a weekly/monthly basis as an alternative to an employee having to make a formal claim under self-assessment procedures direct to Her Majesty's Revenue and Customs (HMRC) at the end of the year. This avoids administration costs for HMRC, the employee in making a claim and provides a reduction of NIC's for the employer.

Key Aims of the Payroll Calculations

The key aims are as follows;

- to provide a mechanism whereby low-paid employees are able to claim expenses earlier than they would have been able to do so via HMRC at the end of the tax year,
- to ensure that potential "exploitation" of such employees is avoided through the use of unfair salary sacrifice schemes which retain part of the sacrifice as highlighted in the recent judicial review hearing,
- to ensure that employees are fully informed of what types of expense can be claimed as a business related expense,
- to ensure that employees' tax affairs are maintained through a clear and unambiguous supply of information,
- to ease the burden on HMRC in processing expenses claims via self-assessment and,
- to embrace proposals put forward by Government on the simplification of PAYE into a "real-time" system.

In order to test the legitimacy of such an arrangement, we have recently undertaken a detailed technical analysis of the legislation which supports the payroll model including reference to the following legislation and internal HMRC guidance manuals including;

- s72 Income Tax (Earnings and Pensions) Act (ITEPA) 2003
- s336 – s 339 Income Tax (Earnings and Pensions) Act (ITEPA) 2003
- Section 3(1) Social Security Contributions and Benefits Act (SSCBA) 1992
- Regulation 25 of the Social Security (Contributions) Regulations 2001
- Paragraph 1 of part VIII of Schedule 3 to the Social Security (Contributions) Regulations 2001.
- Paragraph 3 of part VIII of Schedule 3
- Paragraph 9 of part VIII of Schedule 3
- Paragraph 12A and 13 of part VIII of Schedule 3
- National Minimum Wage Regulations 1999
- National Insurance Manual (NIM) 02010
- National Insurance Manual (NIM) 05644
- National Insurance Manual (NIM) 06250
- National Insurance Manual (NIM) 05020
- Cordant plc v Secretary of State for Business Innovation and Skills and HM Treasury
- Pook v Owen 45 TC 571
- Donnelly v Williamson 1982 STC 88

Conclusion

Based on our technical interpretation of current legislation, the proposed structure will not fall to be caught by the amendment to the National Minimum Wage Regulations (Regulation 31(1)(j)) as inserted with effect from 1 January and is fully supported by the taxes acts and Social Security Regulations.

We understand that up to 7 (seven) specialists from HMRC have been examining the technical aspects of this payroll calculation since January 2011 and have yet to provide a technical analysis as to why such a payroll calculation cannot be effective in granting “relief” in this way.’

Appendix 4 – Extracts from relevant Tax and Social Security legislation

Section 684(7A) ITEPA 2003

'Nothing in the PAYE regulations may be read –

a) As preventing the making of arrangements for the collection of tax (or other amounts) in such manner as may be agreed by, or on behalf of, the payer and [an officer of Revenue and Customs]

or

b) As requiring the payer to comply with the regulations in circumstances in which [an officer of Revenue and Customs] is satisfied that it is unnecessary or not appropriate to do so'

The Social Security (Contributions) Regulations 2001 (SI 2001/1004)

24. 'For the purpose of determining the amount of earnings-related contributions, the amount of a person's earnings from employed earner's employment shall be calculated on the basis of his gross earnings from the employment or employments in question.

This is subject to the provisions of Schedule 2 (calculation of earnings for the purposes of earnings-related contributions in particular cases) and Schedule 3 (payments to be disregarded in the calculation of earnings for the purposes of earnings-related contributions).

Under Schedule 3 *Part VIII*

Travelling, relocation and incidental expenses disregarded

1) The travelling, relocation and other expenses and allowances mentioned in this Part are disregarded in the calculation of an employed earner's earnings.

Travelling expenses – general

2) A payment of, or a contribution towards, qualifying travelling expenses which the holder of an office or employment is obliged to incur and defray out of the emoluments of the office or employment.

For the purposes of this paragraph –

(a)"qualifying travelling expenses" means –
(i) amounts necessarily expended on travelling in the performance of the duties of the office or employment; or
(ii) other expenses of travelling which are attributable to the necessary attendance at any place of the holder of the office or employment in the performance of the duties of the office or employment and are not expenses of ordinary commuting or private travel (within the meaning of paragraph 2 of Schedule 12A to the Taxes Act;

Appendix 5 – Statement by HM Revenue & Customs, July 2011

'Statement by HM Revenue & Customs, July 2011[1]

'Pay day by pay day tax relief models

Who should read this statement

- All umbrella companies, employment businesses, labour providers and employers engaging and paying temporary workers.
- Temporary workers engaged under employment contracts.
- Those in receipt of the services of temporary workers supplied by employment businesses and labour providers, particularly, but not exclusively, workers paid at or near the National Minimum Wage.

Background

HM Revenue & Customs (HMRC) understands that a number of umbrella companies, employment businesses and labour providers are proposing to operate a business model which applies tax, and in some case National Insurance contributions, 'relief' on a pay day by pay day basis: a 'pay day by pay day relief' model.

Under pay day by pay day relief models, temporary workers engaged under overarching employment contracts and who incur travelling and subsistence expenses which are eligible for a tax deduction under section 338 Income Tax (Earnings and Pensions) Act 2003 (ITEPA), are paid a gross pay which is intended to be compliant with the National Minimum Wage legislation. However, rather than then subjecting this gross pay to Income Tax and National Insurance, the employer applies tax and National Insurance contributions 'relief' to the amount of expenses which the employee has incurred with the effect that only the balance is subjected to Income Tax and National Insurance. This tax and National Insurance contributions 'relief' is applied each pay day.

Tax and Social Security legislation

The information obtained by HMRC thus far indicates that the model described above does not comply with the Taxes Acts or Social Security Acts and associated Regulations.

How tax relief is applied

An employer operating such a model is not accounting for the correct Income Tax (PAYE) due to HMRC.

Income Tax is an annual tax and is assessed in respect of a particular 'year of assessment'. Any deductions from Income Tax (for example as provided for under section 338 ITEPA) are made from the total income for the year of assessment.

1 Text now found in the National Archives, at http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/news/relief-models.htm

There are various requirements which must be met in order to receive the benefit of the tax deduction at the end of the tax year. These include that the claim for the deduction by the employee must be made to HMRC- there is no statutory framework for employers to operate the reclaim process.

National Insurance disregards

An employer operating such a model would also not be accounting for the correct employers' and employees' National Insurance contributions due to HMRC.

For the purposes of calculating an employee's earnings, the Social Security Contributions and Benefits Act 1992 provides that 'earnings' includes any remuneration or profit derived from the employment, including wages and salaries.

The Social Security (Contributions) Regulations 2001 provide that payments made by the employer to the employee to cover certain travelling expenses incurred by an employee can be disregarded in the calculation of earnings for National Insurance purposes from the employed earner's employment for the purposes of earnings related contributions (i.e. where such payments are made, those payments will not count as 'earnings' for the relevant earnings period). However, the relevant legislation does not provide for a deduction from the amount of that employee's earnings where the employee meets the travelling expenses out of total income/earnings.

Summary of position

HMRC have set out below the ways in which tax relief and/or a National Insurance contributions disregard can be given effect.

Separate and distinct expense payments or reimbursements made by an employer which are covered by a dispensation

- The employer pays an amount at least equal to or greater than the National Minimum Wage to ensure compliance with the National Minimum Wage legislation. The income and earnings are subject to Income Tax and National Insurance contributions.
- The employer separately and distinctly pays or reimburses an additional amount in respect of certain travelling expenses.
- If those additional payments in respect of travelling expenses are paid under the terms of a valid dispensation, they may be paid without any additional liability to tax.
- The additional payments in respect of expenses would be disregarded for National Insurance purposes.

Separate and distinct expense payments or reimbursements made by an employer that are not covered by a dispensation

- The employer pays an amount at least equal to or greater than the National Minimum Wage to ensure compliance with the National Minimum Wage legislation. The income and earnings are subject to Income Tax and National Insurance contributions.
- The employer separately and distinctly pays or reimburses an additional amount in respect of certain travelling expenses.
- If those additional payments in respect of expenses are not paid under the terms of a valid dispensation,

those additional payments would count as general earnings but the employee can claim a tax deduction from earnings from HMRC at the end of the tax year in respect of expenditure which is eligible for a deduction through Self-Assessment.

- The additional payments in respect of expenses would be disregarded for National Insurance purposes.

Expenses paid by employee out of total income received

- The employer pays an amount at least equal to or greater than the National Minimum Wage to ensure compliance with the National Minimum Wage legislation. The income and earnings are subject to Income Tax and National Insurance contributions but there is no separate and distinct payment in respect of expenses. The employee pays for his travelling expenses from his total income.

- The employee can claim a tax deduction from HMRC at the end of the year in respect of expenditure which is eligible for a deduction through Self-Assessment.

- No National Insurance contributions disregard is available in such circumstances.

What you should do

Those operating pay day by pay day relief models

Consider whether your business model is compliant with tax and National Insurance legislation. If you are in any doubt, you are recommended to seek advice from a professional adviser or HMRC. HMRC is seeking to identify those businesses currently operating pay day by pay day relief models.

Workers/businesses concerned about such models

You can provide HMRC with details, in confidence, about businesses operating such pay day by pay day relief models by email at Temporary workers.'

Appendix 6 – Statement by HM Revenue & Customs, August 2012

'Statement by HM Revenue & Customs, August 20121

'Pay Day by Pay Day Tax Relief Models and Dispensations

Who should read this statement

All umbrella companies, employment businesses, labour providers and employers engaging and paying temporary workers.

Pay Day by Pay Day Tax Relief Models

HM Revenue & Customs (HMRC) published a statement in July 2011 on the subject of Pay Day by Pay Day Tax Relief Models, also given other titles including Pay Day Relief Models. That statement set out HMRC's view that the granting of tax and National Insurance "relief" by an employer each pay day is not compliant with tax and Social Security legislation.

Dispensations

This further statement focuses on the use of Dispensations, particularly in the context of Pay Day by Pay Day Tax Relief Models and other arrangements where expenses are not reimbursed but tax "relief" is claimed to be administered each pay day by the employer to reflect expenses incurred by the employee.

Dispensations are intended to remove the requirement for employers to report certain payments of expenses and benefits at the end of the tax year on forms P11D or P9D. They also remove the need to pay any additional tax which would otherwise be due on payments or benefits covered by a Dispensation. The removal of these requirements only applies to the payments and benefits included in the Dispensation. Employers must continue to report any expenses or benefits not included in a Dispensation in the appropriate manner and pay any additional tax due. Where a dispensation has been issued in respect of Travelling & Subsistence payments, and an employer separately and distinctly makes such a payment, it may be assumed that the payment will be disregarded for national insurance (NICs) purposes.

A Dispensation can only be granted where "payments of a particular character are made to or for any employees or benefits or facilities of a particular kind are provided for any employees" (Section 65(1) Income Tax (Earnings and Pensions Act) 2003). This means where expenses are paid or reimbursed by the employer or payer, or certain benefits are provided to employees by the employer.

Expenses that are not made to or provided for any employees by the employer cannot be included in, or afforded the protection of, a Dispensation. To give effect to tax relief in respect of expenses not afforded the protection of a Dispensation, an employee, or their authorised representative, needs to make a claim by letter, form P87, or their Self-Assessment Tax Return. The fact that HMRC has granted a Dispensation to the employer does not negate the

1 Now found in the National Archives, see http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/news/news290812.htm

need for an employee or their authorised representative to make a claim where the employer has not made a payment of expenses.

Where an employer seeking a Dispensation clearly states in the original application, or in answer to a question from HMRC, that the employer will not pay or reimburse Travel & Subsistence expenses, HMRC will not grant a Dispensation that includes such Travel & Subsistence expenses.

Scale rate payments and the Advisory Benchmark Scale Rates can only be used for expenses made to or provided for any employees by the employer and where agreed as part of a Dispensation: they cannot be used by an employer to arrive at a sum on which tax and NICs "relief" is given each pay day where the expenses are incurred by the employee and not reimbursed by the employer.

HMRC may revoke a Dispensation where it believes that additional tax is payable in respect of payments or benefits. Alternatively HMRC could seek to take action to collect additional tax and NICs without disturbing the Dispensation because the administration of tax "relief" in this way is not sanctioned by the protection of the Dispensation and NICs "relief" is not available unless separate and distinct payments of expenses have been made.

For the avoidance of doubt, a Dispensation is granted based on information provided to HMRC by an employer and where HMRC is satisfied, based on that information, that no additional tax is payable in respect of payments or benefits. In agreeing a Dispensation, HMRC is not expressing any other view or agreement on anything other than the payments made or benefits provided that form the basis of the Dispensation.'

Appendix 7 – Extracts from the Income Tax (Pay As You Earn) Regulations 2003

72. Recovery from employee of tax not deducted by employer

(1) This regulation applies if –

(a) it appears to the Inland Revenue that the deductible amount exceeds the amount actually deducted, and

(b) condition A or B is met.

(2) In this regulation –

- "the deductible amount" is the amount which an employer was liable to deduct from relevant payments made to an employee in a tax period;
- "the amount actually deducted" is the amount actually deducted by the employer from relevant payments made to that employee during that tax period;
- "the excess" means the amount by which the deductible amount exceeds the amount actually deducted.

(3) Condition A is that the employer satisfies the Inland Revenue—

(a) that the employer took reasonable care to comply with these Regulations, and

(b) that the failure to deduct the excess was due to an error made in good faith.

(4) Condition B is that the Inland Revenue are of the opinion that the employee has received relevant payments knowing that the employer wilfully failed to deduct the amount of tax which should have been deducted from those payments.

(5) The Inland Revenue may direct that the employer is not liable to pay the excess to the Inland Revenue.

(6) If a direction is made, the excess must not be added under regulation 185(5) or 188(3)(a) (adjustments to total net tax deducted for self-assessments and other assessments) in relation to the employee.

(7) If condition B is met, tax payable by an employee as a result of a direction carries interest, as if it were unpaid tax due from an employer, in accordance with regulation 82 (interest on tax overdue).

(8) The tax payable carries interest from the reckonable date until whichever is the earlier of –

(a) the date on which payment is made, or

(b) the date (if any) immediately before the date on which it begins to carry interest under section 86 of TMA(1).

80. Determination of unpaid tax and appeal against determination

(1) This regulation applies if it appears to the Inland Revenue that there may be tax payable for a tax year under regulation 68 by an employer which has neither been—

(a) paid to the Inland Revenue, nor

(b) certified by the Inland Revenue under regulation 76, 77, 78 or 79.

(2) The Inland Revenue may determine the amount of that tax to the best of their judgment, and serve notice of their determination on the employer.

(3) A determination under this regulation must not include tax in respect of which a direction under regulation 72(5) has been made; and directions under that regulation do not apply to tax determined under this regulation.

(4) A determination under this regulation may—

(a) cover the tax payable by the employer under regulation 68 for any one or more tax periods in a tax year, and

(b) extend to the whole of that tax, or to such part of it as is payable in respect of—

(i) a class or classes of employees specified in the notice of determination (without naming the individual employees), or

(ii) one or more named employees specified in the notice.

(5) A determination under this regulation is subject to Parts 4, 5 (other than section 55) and 6 of TMA (assessment, appeals, collection and recovery) as if—

(a) the determination were an assessment, and

(b) the amount of tax determined were income tax charged on the employer,

and those Parts of that Act apply accordingly with any necessary modifications.

(6) For the purposes of paragraph 3(1)(a) of Schedule 3 to TMA(1) (rules for assigning proceedings to General Commissioners), the relevant place for an appeal against a determination under this regulation is the place where the determination was made.

Appendix 8 – Acknowledgements

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Appendix 9 – Glossary of abbreviations and forms

AWR	Agency Workers Regulations
BSR	Benchmark Scale Rates
CIOT	Chartered Institute of Taxation
DOTAS	Disclosure of Tax Avoidance Schemes
DWP	Department of Work and Pensions
FRE	Flat Rate Expenses
FSC	FS Commercial
GAAR	General Anti Abuse Rule
GLA	Gangmasters Licensing Authority
HMRC	HM Revenue & Customs
IR35	Common name of legislation designed to tax "disguised employment" at a rate similar to employment.
ITEPA	Income Tax (Earnings and Pensions) Act
JSA	Jobseeker's Allowance
LEL	Lower Earnings Limit
LITRG	Low Incomes Tax Reform Group
MSC	Managed Service Companies
NIC	National Insurance contributions
NMW	National Minimum Wage
OTS	Office of Tax Simplification
PAYE	Pay As You Earn
PDPD	Pay Day by Pay Day
PSC	Personal Service Companies
P11D	Form upon which particulars of any expenses payments, benefits and facilities provided to employee earning at a rate of £8,500 or more a year are sent to HMRC by employers
P87	Form to claim tax relief for expenses of employment
P800	Sent to workers at the end of the tax year if they are due a tax refund or they need to pay more tax.
QC	Queen's Counsel
RTI	Real Time Information
TAAR	Targeted Anti-Avoidance Rule
UC	Universal Credit