

**Consultation on off-payroll working in the private sector
Response from the Low Incomes Tax Reform Group (LITRG)**

1 Executive Summary

- 1.1 We are pleased to have the opportunity to respond to the consultation on off-payroll working in the private sector. As our focus is always on those on low incomes and the unrepresented, our main comments are made from the perspective of both the low-income worker and the small, unrepresented business.
- 1.2 We appreciate that the Government have considerable concerns regarding the non-compliance of the rules commonly known as IR35 in the private sector. We share these concerns and want people to pay the right amount of tax; however, we think the Government should proceed cautiously with implementing the changes made in the public sector into the private sector and in any event, should defer making a decision for a year or two.
- 1.3 We have many reasons for saying this – for example, it is still unclear how successful the public sector changes have been. HM Revenue & Customs' (HMRC) external research on the public sector cannot offer us any meaningful indication of how things might work for smaller businesses in the private sector, as the two populations are so vastly different. We think that the Government also needs to hear the opinions of independent commentators, via the feedback to this consultation, so that they have a more complete picture.
- 1.4 In the meantime, HMRC should refocus on ordinary IR35 investigative work. We appreciate that there are significant challenges with enforcing IR35 in the private sector. However if HMRC risk assessed the best cases to take and made resulting investigations and

prosecutions more visible and publicised then we think this could make a real difference. As part of their tax abuse and insolvency work, HMRC could also potentially write in some specific debt transfers provisions to address the problems of tax driven PSC insolvencies.

- 1.5 This calm and measured approach to the private sector would also allow room for the outcome of the employment status consultation to be factored in as necessary. Employment status is inextricably linked to the question of IR35/off-payroll working and bringing in a set of rules, only for the underlying employment status regime to change later down the line, would cause chaos.
- 1.6 In the event that off-payroll working for the private sector is rolled out in due course, we strongly recommend that an exemption is applied to small businesses. We have significant concerns about the impact that the roll out of the public sector rules would have on this constituency. As the Government has indicated on many occasions, they wish to keep the tax system as simple as possible and to minimise the administrative burdens on business in general – aims which we fully endorse. However, it is our view that any extension of the off-payroll working rules to the private sector is completely at odds with this intention, as this proposal is both complicated and potentially administratively time consuming for small businesses.
- 1.7 Small businesses are less likely to have the technical expertise or capacity to understand and apply the new rules than public sector bodies. If they are not exempt, many would be forced to pay for professional advice or assistance if they were to engage a worker via a PSC, which they may not be able to afford. Alternatively, they would have to dedicate time and resources to getting to grips with the new rules themselves, which would be disruptive, stressful and potentially affect productivity.
- 1.8 Note, we also have severe reservations about how useful HMRC's online Check Employment Status for Tax (CEST) tool would be in the context of small businesses with non-specialist staff. The tool will need to be redesigned and this is just one of the reasons that any changes to the private sector will need a significant lead-in time.
- 1.9 We are also concerned about the impact of any changes on low-income workers in PSCs – something not really addressed in the consultation document. Such workers are probably not in a PSC out of choice, but at the behest of an agency or other intermediary, such as an umbrella company, who can then save on employer National Insurance contributions (NIC) and can also charge an ongoing fee for 'accountancy' services to help the worker run the PSC.
- 1.10 The application of the new rules would see an overall reduction in the income to the PSC and so to the worker (made worse where the employer NIC cost is passed to them). Low-income workers, who probably had little choice but to work through a PSC in the first place, are unlikely to be in a position to insist on higher gross pay rates to compensate for this; so the effect of the new rules will be to generate more revenue from some of the lowest paid and most vulnerable workers in society.

- 1.11 Alternatively, with the tax advantage gone (which would have mainly been accruing to their engagers anyway), low-income workers will be moved out of PSC's into other types of arrangements, e.g. umbrella arrangements, many of which are non-compliant and can mean further, different problems later down the line for both the worker and Exchequer alike. This also leaves potentially messy compliance issues with regards to the mass abandonment of PSCs.
- 1.12 It occurs to us that these changes may well prompt HMRC to look not just at the future but at past tax compliance. If the hiring business decides, under the new rules, that the worker is a deemed employee, that calls into question their past compliance with IR35. If these changes go through, we would welcome HMRC's confirmation that they will not seize on the opportunity to open historic IR35 enquiries for low-paid workers, particularly as these workers will have had little choice or understanding as to what they were entering into in the first place.
- 1.13 In terms of other options, ultimately, with the changes to tax on dividends, it is the National Insurance differential that drives the creation of many PSCs. We recognise that there are no easy answers when it comes to what to do about NIC, but the landscape is radically changing for workers – the development of the gig economy, the shift away from permanent and direct employment, the more frequent switching between employment and self-employment. We do not think that tackling the issues coming out of these changes in a piecemeal fashion is working. For a long-term, sustainable solution, it seems to us that it is time for a more fundamental 'root and branch' debate of all the issues around taxation of the labour market.

2 About Us

- 2.1 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 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.
- 2.2 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.
- 2.3 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 Our approach to this consultation

- 3.1 In general, we are worried that these proposals contribute to a worrying trend of HMRC not being seen to have a strong and effective enforcement function. This encourages those seeking to disregard or circumvent the rules (not just around IR35, but in wider labour market scenarios) to chance their arm, as they have little fear of being caught or punished. The low-paid are often the ones to bear the brunt of the fall out.
- 3.2 We also think that less open, more complex supply chains in the private sector (with less due diligence perhaps) means more low-paid workers in PSC's will be caught up in these changes than in the public sector changes. However neither this fact, nor what the changes might mean from the workers perspective, are covered in the consultation.
- 3.3 As such, we have specifically answered questions 1 and 34 to address these issues, as we think this is where we can add most value.
- 3.4 We have offered high level comments around the other sections of the consultation document, which when taken together should provide useful input to questions 2 – 13 (extending the public sector reform to the private sector), questions 14 – 31 (encouraging or requiring businesses to secure their labour supply chains/additional record keeping) and questions 32 and 33 (other options).
- 3.5 These supplement the more detailed comments that our CIOT and Association of Taxation Technicians (ATT) colleagues have made in these areas, which we fully endorse.

4 Specific Questions

- 4.1 ***Q1 What could be done to improve the compliance enquiry process to reduce non-compliance, whilst safeguarding the rights of customers?***
- 4.1.1 We sympathise with HMRC that IR35 issues are time-consuming and difficult to investigate but this does not mean that investigations should not be undertaken where appropriate. HMRC are the body tasked with the 'collection and management' of revenue¹ and, unfortunately, long and complex investigations are the nature of compliance and enforcement work.
- 4.1.2 We also understand that HMRC are operating against a backdrop of reduced resources, however in our view the answer does not lie in increasing the numbers of investigations. It lies in making better risk assessments of individual cases and then undertaking a more proactive and visible approach to the investigations and prosecutions that HMRC do pursue, which would act as a serious disincentive to those considering gaming the system.

¹ The Commissioners for Revenue and Customs Act 2005 (CRCA 2005), s 5(1)

- 4.1.3 In terms of being more visible, we suggest HMRC publicise their actions in news items on GOV.UK and in 'Spotlights', for example.¹ While we appreciate that HMRC's standard approach is that they do not comment on the affairs of individual taxpayers due to the duty of confidentiality, our view is that not divulging any details whatsoever is counterproductive and so HMRC should consider if any new statutory powers are needed to facilitate them to do so in certain circumstances.²
- 4.1.4 HMRC should see if they can learn anything from The Pensions Regulator (TPR) who are widely regarded as successful and effective at enforcing the auto enrolment programme. In particular, their enforcement and compliance bulletins³ make for interesting reading, setting out the cases and powers TPR have used in the quarter relating to automatic enrolment and associated employer duties.
- 4.1.5 Where the TPR consider a case is sufficiently important they may publish specific details.⁴ While they use these powers in a measured way, they say having the ability to publish detailed information about their enforcement activity plays a vital part in securing the important outcomes of transparency, education and guidance and deterrence:
- Transparency: We recognise that it is in the public interest to ensure that everyone has a greater understanding of how we exercise our statutory functions. An important aim of publication is to increase understanding of how and when we have used our powers.*
- Education and guidance: To provide guidance to improve practices, behaviours and compliance with legal obligations which otherwise might lead to intervention; and to encourage higher standards by sharing good practice.*
- Deterrence: To deter unlawful or improper practices or behaviours, to increase awareness of such practices or behaviours and to inform others who may be adversely affected by such practices or behaviour*
- 4.1.6 We suggest that what the TPR are doing, as well as other comparators with an enforcement function (for example, the Gangmasters Licencing and Abuse Authority⁵) would be worth investigating further as part of HMRC's work in this area.

¹ <https://www.gov.uk/government/collections/tax-avoidance-schemes-currently-in-the-spotlight>

² s18 Revenue and Customs Act 2005, provides that HMRC may not disclose any information held by HMRC except if that disclosure is "made for the purposes of a function" of HMRC.

³ <http://www.thepensionsregulator.gov.uk/docs/compliance-and-enforcement-quarterly-bulletinjanuary-to-march-2018.pdf>

⁴ <http://www.thepensionsregulator.gov.uk/doc-library/regulatory-intervention-reports.aspx>

⁵ The GLAA also write up case studies for press releases: <http://www.gla.gov.uk/whats-new/latestpress-releases/290118-cornish-gangmaster-revoked-after-string-of-issues-uncovered/>

- 4.1.7 We understand that there may be difficulties when it comes to HMRC collecting any taxes owed, given that the reaction to an IR35 investigation and prosecution is often the dissolution of the PSC. However, where the insolvency is clearly tax driven, we suggest this could be dealt with by introducing precisely targeted new provisions which allow HMRC to transfer the liability to the director personally.¹
- 4.1.8 Current provisions, e.g. Regulation 72 of PAYE Regulations 2003, wilful failure, do not appear to be all that helpful to HMRC in an IR35 context, as even though it falls within the employment tax regime, in order to be able to collect the Pay As You Earn (PAYE) from the director personally, HMRC need to prove that the director received payments knowing that their company wilfully failed to deduct and pay over the amount of tax due. As IR35 is so complex, many directors can simply say that nothing was done deliberately and all appropriate steps had been taken to try and comply.²
- 4.1.9 These changes should be given a chance to work. If, after a suitable amount of time, the evidence suggests that they are not having the intended impact, then it would be reasonable for HMRC to look at taking action to secure compliance in the private sector again.
- 4.1.10 This approach would also allow room for the outcome of the employment status consultation to be factored in as necessary. The fundamental principle of applying IR35 rules and/or off-payroll working rules is that employment status must be properly considered to establish whether there is actually an employee/employer relationship between the worker and the engager. In view of the recent Government consultation on employment status following the Matthew Taylor review in 2017, we do not believe it would be sensible to extend the off-payroll working rules to the private sector if the underlying employment status regime is going to be changed later down the line.³
- 4.2 ***Q34 Are there any other issues which businesses or individuals who may be affected would like to raise?***
- 4.2.1 Little thought seems to have been given to what impact any changes in the private sector might have on workers.
- 4.2.2 We note that the examples in the consultation document relate to relatively highly paid 'workers'. However there are likely to be a number of low-paid workers in PSC's working in

¹ There are examples of the use of such debt transfer provisions set out in recent response to HMRC's tax abuse and insolvency consultation: <https://www.litrg.org.uk/sites/default/files/180620-LITRG-response-Tax-abuse-insolvency-FINAL.pdf>

² An interesting article summarising the position with regards IR35 and personal liability can be found here: <https://www.whitefieldtax.co.uk/ir35-and-personal-liability-can-hmrc-proceed-against-an-individual/>

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[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/679853/FINAL - Employment Status consultation - FOR UPLOADING and PRINTING.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/679853/FINAL_-_Employment_Status_consultation_-_FOR_UPLOADING_and_PRINTING.pdf)

the private sector.¹ These tend to be individuals, working on a temporary basis, with little power or influence as far as their relationship with the engager goes. They are probably not in a PSC out of choice, but at the behest of an agency or other intermediary,² such as an umbrella company, who can then save on employer NIC and can also charge an ongoing fee for 'accountancy' services to help the worker run the PSC.

- 4.2.3 Most low-paid workers working through a PSC will be within IR35 as they have little autonomy but few, if any, we suggest, will be paying tax on IR35 deemed payments. The tax 'advantage' accruing as a result of this non-compliance is largely swallowed up in the accountancy fees paid to the intermediary. Should this tax advantage disappear, it seems likely that workers will be pulled out of PSCs and put into other types of arrangements, e.g. umbrella arrangements, as the money making opportunity for the intermediary will be gone.
- 4.2.4 However, many umbrella models are non-compliant and HMRC do not have a firm grip on them. For example, the umbrella company might still participate in practices such as substituting inflated travel expenses for some elements of pay.³ The worker is unlikely to understand what is happening with their pay and taxes and there will still be tax lost.
- 4.2.5 In addition, HMRC need to be aware that there are also potentially very messy compliance issues stemming from the mass abandonment of PSCs. It seems unlikely that the accountancy 'service' provider will be prepared to deal with the winding up of the company as part of their normal fee. This will therefore present a further opportunity to make money out of low-income workers in PSCs.
- 4.2.6 For those workers that cannot or will not pay (the majority we suggest), huge difficulties await. Those at the low-income end of the spectrum who are forced to use PSCs have very little understanding of how such vehicles operate. They often cannot separate out their own affairs from the PSCs, and stand very little chance of closing down the PSC's tax affairs correctly, let alone deal with the companies house requirements.
- 4.2.7 Of course, not all workers will be switched out of PSCs. However, those workers remaining in PSCs will have little bargaining power to increase their rate to take into account their new deductions and the fact that the employer NIC cost on the end client/fee payer will probably be passed down the chain. So, while the private sector changes will undoubtedly collect more tax, it is likely to hit the pockets of the low-paid disproportionality. Further, having to factor in PAYE tax and NIC deductions from company income complicates the accountancy

¹ Many of the issues raised in Section 5 of the House of Lords report on Personal Service Companies published in April 2014 remain pertinent:

<https://publications.parliament.uk/pa/ld201314/ldselect/ldpersonal/160/160.pdf>

² Lots of umbrella companies offer Ltd company 'services': e.g. <https://www.umbrella.co.uk/>

³ Other non-compliant models are set out in our response on Agency workers:

<https://www.litrg.org.uk/latest-news/submissions/180508-good-work-taylor-review-modern-working-practices---agency-worker>

position so it is likely that they will also have to pay more to the intermediary for the accountancy services – a double whammy.

- 4.2.8 Ultimately, such low-paid workers will be paying employee taxes but will probably not be receiving commensurate employee employment rights. We think that where an individual is, in effect, a ‘deemed employee’ then it would seem logical and fair that not only is PAYE/NIC accounted for but that the individual benefits from employment and associated rights from the end client/fee payer as well. We would urge HMRC to work with other areas of Government, e.g. BEIS, to consider how this can be achieved.
- 4.2.9 Finally, these changes may well prompt HMRC to look not just at the future but at past tax compliance. If the end client decides under the new rules that the worker is a deemed employee, that calls into question their past compliance with IR35. If the PSC has not been accounting for a deemed payment, HMRC is likely to come calling. If these changes go through, we would welcome HMRC’s confirmation that they will not seize on the opportunity to open historic IR35 enquiries for low-paid workers – particularly given the fact that the relationship with the PSC ‘accountants’ is likely to trail off at the first sign of trouble, leaving them with no one to turn to for help.

5 General comments

5.1 *Q2-13 Extending the public sector reform to the private sector*

- 5.1.1 This is clearly the Government’s favoured option, however we do not fully agree that the available evidence shows that the public sector reform has been effective in tackling non-compliance with the off-payroll working rules.
- 5.1.2 Moreover, it is disappointing that the government is hailing the success of new legislation regarding off-payroll working in the public sector without waiting for the impact of a full year’s operation of the new system to be known. While the figures quoted¹ seem to show more people paying income tax and NIC as a result of the new rules, as yet it is impossible to know the overall financial effect, as clearly there will be a reduction in the corporation tax and income tax that would otherwise have been collected from the PSC and its director(s).²

¹ We understand that 58,000 extra individuals are paying an additional £410 million in income tax and NICs.

² There were other changes brought in in April 2017 that could also explain some of the figures – for example, the changes to the flat rate VAT scheme. The additional income stream that could be made from the flat rate VAT scheme was sometimes a factor in professional people deciding to give freelancing/contracting a go, whether as a sole trader or via a PSC. Now that the flat rate VAT advantages have been removed for limited cost traders, it is possible that such people will have returned to more traditional employment arrangements. It is unclear to us whether such people

- 5.1.3 In terms of the external research published with the consultation document, we think the 'positive' findings are limited in terms of what they can tell us about how the rules would work for smaller businesses in the private sector, as the two populations are so very different.
- 5.1.4 For example, the research states that although a considerable proportion of public authorities experienced early difficulties in complying with the rules, almost all of those surveyed said they were now confident they were complying with the rules. However, the public sector is not made up of commercial businesses focussed on trying to be successful/make a living. Public bodies have substantial resources to consider new legislation and the potential issues arising if mistakes are made, while large public sector bodies also have the ability to bear any financial penalties. Moreover, they are probably more familiar with the IR35 rules as some public sector bodies were already having to determine the employment status of off-payroll workers (that are engaged for more than six months and paid more than £220 per day) in order to seek assurances from the workers that the correct taxes were being accounted for.
- 5.1.5 That is not replicated by much of the private sector in which there are a vast spectrum of businesses – many of which are very small. People running such businesses may not have the time or capability to understand and apply the new rules. They may have minimal HR or accounting functions in-house and might have to pay for advice or assistance, thus incurring costs (which will almost certainly be disproportionate to the size of their business) – lowering their profitability.
- 5.1.6 Alternatively, they would have to dedicate time and resources to getting to grips with the new rules themselves, which could be stressful, time consuming and potentially affect productivity. Worst-case scenario is that private sector businesses just put the whole thing in the too hard basket and apply blanket 'employee' rulings – which would negatively affect the 66% odd of PSCs who do not currently fall within IR35.¹
- 5.1.7 There are also a number of worrying findings from the research, where the impacts for small businesses in the private sector are likely to be amplified. For example, the research found that some public authorities have found it harder to fill off-payroll vacancies since the reform was introduced (32% of central bodies and 22% of sites). If the rules are extended to the private sector, it is likely that more small businesses will struggle to fill vacancies, which can be disruptive and distracting for the business.
- 5.1.8 Additionally, a large number of public sector bodies (46% of central bodies and 31% of sites) reported disputes with contractors over the application of the off-payroll working rules to

moving from PSC's back to PAYE employment as a result of the flat rate VAT changes have been factored in to the figures.

¹ The Government says there were one million personal service companies in 2015 and HMRC estimate one third (33%) should be applying the IR35 provisions, of which 10% are

them. Such disputes can strain working relationships and in a small business environment they can be very damaging.

- 5.1.9 HMRC will no doubt say that the availability of HMRC's online CEST tool will make status assessments quick and easy assessments and will mitigate burdens on small private sector businesses. However many in the tax profession and wider industry have severe reservations about the accuracy and usability of CEST.¹
- 5.1.10 We are also concerned that the tool is not suitable for use by laypersons – understanding and answering the questions with the accuracy that HMRC might expect currently requires a reasonable degree of sophistication and an understanding of the underlying case law tests. It seems to us that the entire tool will need to be redesigned/calibrated if more small businesses with non-specialist staff are to use it and rely on its conclusion.
- 5.1.11 This has obvious implications for HMRC in terms of administrative capacity. Further, the consultation advises that there have been over 750,000 uses of CEST to February 2018 and it was able to generate clear decisions in 85% of cases. The remaining 15% of cases needed more detailed assistance and support, and we assume this came from the specialist helpline staffed by HMRC. Clearly, there will be an increased use of CEST if the private sector changes go ahead, and even with a cohort of around 15% needing more specialist help from the helpline team, this support facility will need to be scaled up.
- 5.1.12 There is no suggestion in the consultation document that the new rules would only catch large businesses. Should these private sector changes go ahead, we strongly recommend that an exemption is applied to small businesses. Not only are there principled reasons behind this recommendation (i.e. HMRC should not, in our view, be abdicating their IR35 policing responsibility to small businesses); there are also practical reasons, as small businesses will be most likely to struggle to get to grips with new legislation along the lines currently being considered.
- 5.1.13 We suggest HMRC consult on what such an exemption could look like further. We would also welcome confirmation that business to consumer arrangements, e.g. where a PSC plumber provides his services to a private homeowner, are outside the scope of these changes. For all others, it goes without saying that a significant lead in time will be required to prepare and adapt.
- 5.2 ***Q14-31 Encouraging or requiring businesses to secure their labour supply chains/additional record keeping***
- 5.2.1 We do not really favour either of these options.

¹ <https://ion.icaew.com/taxfaculty/b/weblog/posts/off-payroll-working-ir35-in-public-sector-regime-needs-fixing>

- 5.2.2 The first option expects businesses to complete audits of their labour supply chains. This seems complex to administer and will require additional resources for businesses to manage.
- 5.2.3 In terms of businesses understanding whether or not any workers supplied by PSCs are complying with IR35 rules, we do not see how requiring a PSC to provide a completed CEST determination will do much by way of achieving this. Surely the only real way of knowing this is to check the self-assessment tax return of the director or the PSC to ensure that he or she has calculated the deemed payment?
- 5.2.4 However, this seems practically challenging to implement. This would require the exchange of detailed/sensitive information – are there data protection considerations? Will the person checking the tax return know what they are looking at? What if the tax return is subsequently amended?
- 5.2.5 Similarly, while it is all very well to require businesses to retain more paperwork relating to the engagement, such as contracts, shift rotas, and line management reporting requirements, this still may not help HMRC understand what the actual working practices were like as contract terms, etc. might well not reflect what actually happens so the ‘real world’ nature of arrangements on the ground.
- 5.2.6 This does not seem to bring us any further forward. Our initial reaction is that the bureaucracy involved in this option is likely to be very burdensome on all (including HMRC), without directly affecting compliance.
- 5.3 ***Q32 and 33 Other options to consider***
- 5.3.1 Over the last few years changes have been made to dividend tax with all dividends above the £2,000 threshold now subject to tax, albeit they have no National Insurance charge. With the changes to tax on dividends, it is the National Insurance differential that drives the creation of many PSCs, particularly those that are formed at the behest of the engagers.
- 5.3.2 Removing the distortion created by this anomaly would be the most effective form of ensuring better compliance with IR35 as the need to operate in this way would be obviated. Then only those PSCs formed for other commercial reasons would remain, and there should then be less need for ‘patching’ legislation of this nature to stem perceived avoidance.
- 5.4 We recognise that there are no easy answers when it comes to what to do about NIC, but the landscape is radically changing for workers – the development of the gig economy, the shift away from permanent and direct employment, the more frequent switching between employment and self-employment. Ultimately, we do not think that tackling the issues coming out of these changes in a piecemeal fashion is working. For a long term, sustainable solution, it seems to us that it is time for a more fundamental ‘root and branch’ debate of all the issues around the taxation of the labour market.