

**HM Revenue & Customs (HMRC) consultation:
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 latest consultation on the introduction of off-payroll working rules to the private sector from April 2020. This consultation looks at the detailed operation of the reform.
- 1.2 We welcome the decision to delay the rollout of the off-payroll working rules to the private sector as businesses need adequate time to prepare for what lies ahead. However, we do not think the reform should go ahead until the concerns raised about the potential impacts on workers are adequately addressed.
- 1.3 In our response to the original consultation, amongst other things, we called for an exemption for small, potentially unrepresented businesses and highlighted the potential impact of the changes on low-paid workers.
- 1.4 Various concessions have now been announced, including the exemption of small businesses and that enquiries into previous years will not automatically be triggered (when individuals start paying employment taxes under IR35 for the first time following the reform).¹ These are welcome as they address a number of the points we raised. However, questions still remain about the detail.

¹ See para 9, bullet 2: <https://www.gov.uk/government/publications/off-payroll-working-in-the-private-sector-ir35-budget-2018-brief>

- 1.5 For example, is not clear to us that by framing the small business exemption in the way proposed, whether business-to-consumer arrangements will fall outside the scope of the changes. Such an arrangement could exist for instance, where a carer provides services to a disabled individual/private householder via a personal service company (PSC).
- 1.6 Furthermore, while HMRC have confirmed in their briefing sheet¹ that they will not run any targeted campaigns looking at past IR35 compliance, we understand that following the ruling in *Christianuyi*,² HMRC might be considering investigating previous arrangements under the Managed Service Company (MSC) legislation instead.³ We would welcome the opportunity to discuss this further.
- 1.7 In addition, our concerns about what will happen to workers who are only in PSCs at the behest of their engagers have not been addressed.
- 1.8 Many low-income workers often find that they are offered work in the private sector on the basis that they will structure their work through a PSC. This can help save tax/NIC for both them and their engagers. With the tax/NIC 'advantage' gone, it is likely that many workers will be pulled out of PSCs by their engagers. This has two potentially serious ramifications for the worker.
- 1.9 Firstly, depending on whether the PSC is closed down correctly, the worker could be left with messy limited company and corporation tax compliance issues that they do not understand and that could follow them around for years. We would therefore like to see HMRC working with Companies House to come up with a way of making it as easy as possible for taxpayers to close down PSCs themselves in conjunction with an amnesty for any accrued penalties.
- 1.10 Secondly, workers could be put into potentially non-compliant umbrella arrangements, which should be a significant concern to the government. Indeed, one of the outcomes of the public sector changes⁴ was a mass shift of contractors (often unwittingly) into highly aggressive umbrella models, including ones based on loan arrangements. The fallout from

¹https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752074/IR35_web.pdf

² <https://www.gov.uk/government/publications/spotlight-32-managed-service-company-legislation-tax-avoidance-scheme-involving-unpaid-payee-and-class-1-national-insurance-contributions/spotlight-32-managed-service-company-legislation-tax-avoidance-scheme-involving-unpaid-payee-and-class-1-national-insurance-contributions>

³ As set out in this article: <https://www.qdoscontractor.com/news/2019/04/16/managed-service-company-legislation-rears-ugly-head>

⁴ See, for example, 'Nurses & agencies using umbrella loan schemes risk tax bills and prosecution', 1 February 2018: https://www.contractorcalculator.co.uk/nurses_agencies_umbrella_loan_schemes_538610_news.aspx

many ex-PSC public sector workers now facing the loan charge¹ will no doubt continue to reverberate for some time. This potential problem for workers is also highlighted in this recent query to our website: *'Hi, the Umbrella Company I am with make charges to process statutory payments such as my holiday pay or if I qualify for SSP. Are you able to clarify if they are allowed to do this?'*

- 1.11 Thus, unless HMRC take action to close down non-compliant umbrella companies before the private sector changes come in, vulnerable workers could end up in exploitative working arrangements. Moreover, some of the £1.3 billion per year IR35 losses that the government is hoping to secure may not materialise, as existing arrangements might just be displaced by other, different types of tax avoidance.
- 1.12 HMRC's ability to successfully tackle these non-compliant arrangements, and ultimately protect employees against exploitative practices, requires adequate resources as well as a clear plan for action.

2 About Us

- 2.1 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.

¹ <https://www.gov.uk/government/publications/hmrc-issue-briefing-disguised-remuneration-charge-on-loans/hmrc-issue-briefing-disguised-remuneration-charge-on-loans>

3 Introduction

3.1 In our original submission,¹ we explained that the main focus of our concern was for the workers – and in particular that the reforms would lead to a large-scale migration of workers away from PSCs into alternative arrangements.

3.2 The government response to the consultation contained the following passing reference to our concerns:

‘The government also received a number of submissions and correspondence from individuals about the impact of the public sector reforms on the labour market and on workers themselves. A number of respondents raised concerns that the public sector reform has led to new avoidance schemes being marketed to individuals, and increased reliance on alternative models for engaging labour such as umbrella companies.’²

3.3 However, in the ‘Government response’ box immediately following the above paragraph, no obvious comments were made about how these concerns would be addressed. These very serious and legitimate concerns must be addressed. The fact that the ‘new avoidance schemes being marketed to individuals’ included loan arrangements, and that many of those same individuals are now having to deal with the hugely controversial loan charge, clearly demonstrates that our concerns are justified.

3.4 We are not aware of any published research carried out by HMRC into the increased use of alternative schemes since the introduction of the public sector changes. We think HMRC should prioritise gathering such evidence or statistics prior to making a final decision on these proposals.

3.5 On this basis, the main purpose of our response to this consultation is to make our points again – in more detail – in the hope that this will highlight the need for HMRC to investigate the matter further and take action - aiming to prevent a similar situation to that of low-income workers being caught by the loan charge from happening again. After making some general comments in section 4 below, we answer only one of the specific questions, number 18, in section 5.

3.6 This response supplements the detailed comments that our CIOT and Association of Taxation Technicians (ATT) colleagues have made, which we fully endorse.

¹ <https://www.litrg.org.uk/latest-news/submissions/180809-payroll-working-private-sector>

²

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752160/Off-payroll_working_in_the_private_sector_-_summary_of_responses.pdf (para 2.17)

4 General comments

- 4.1 We welcome the decision to delay until April 2020 the rollout of the off-payroll working rules to the private sector. As much time as possible is required for businesses and workers to prepare for what lies ahead and for the government and HMRC to address the concerns LITRG and many other organisations raised, including with the Check Employment Status for Tax (CEST) service. We think it is vital that an improved, reliable version of CEST is put in place as soon as possible.¹
- 4.2 This should also allow time for the government to complete its assessment of the employment status rules that were subject to consultation last year.² As these underpin IR35, it makes sense to have some clarity in this area before any further change.
- 4.3 In our original response, we strongly recommended that an exemption be applied to small businesses for both principled and practical reasons. We therefore welcome the fact that there is to be such an exemption.
- 4.4 We understand that the ‘small business’ exemption is going to be defined by reference to the Companies Act for corporate entities (i.e. where two of the following criteria are met: turnover of no more than £10.2 million; balance sheet of no more than £5.1 million; and/or no more than 50 employees). Small non-corporate entities look like they will have to meet an alternative test based on turnover and/or the number of employees of the organisation.
- 4.5 In terms of whether this alternative test should require *either* or *both* criteria to be met in order to qualify as small, it seems to us that it would be preferable for an organisation to continue to qualify as small until they breach both conditions. This would minimise the effect of a cliff-edge around the 50-employee threshold and widen the exemption more generally.
- 4.6 However, we wonder whether this ‘small’ criteria is at risk of exploitation.³
- 4.7 Also, it is not clear to us whether business-to-consumer arrangements will be caught if the exemption is framed in this way. For example, where a carer provides services to a disabled individual/private householder via a PSC, we assume that it should fall outside the scope of

¹ While we welcome the fact that HMRC will continue to work with stakeholders to improve further CEST and guidance before the reform comes into effect, it is becoming harder to see how a rigid tool can deal with all the complexities that can exist in working relationships these days. Recent cases involving major celebrities like Lorraine Kelly (<https://www.bailii.org/uk/cases/UKFTT/TC/2019/TC07045.html>), where the Courts have taken a different view of IR35 to the CEST tool/HMRC, illustrate the point.

² <https://www.gov.uk/government/consultations/employment-status>

³ For reasons including those set out in this article: https://www.contractorcalculator.co.uk/payroll_ir35_small_company_exemption_vulnerable_549110_news.aspx

these changes. However, the continued reference to the end clients being incorporated/unincorporated small 'organisations', is confusing. An individual is, after all, not an organisation, but could easily have regular arrangements with a trader who operates through a company. Other examples would include gardeners or nannies. The government and HMRC must make it clear that such situations are not affected.

- 4.8 It would be extremely regrettable if one consequence of the changes was that such end clients stopped contracting with PSCs due to the perceived risks/inherent administrative burdens – particularly considering the people operating through PSCs in the contexts described above are likely to be in business on their own account would probably fall outside of IR35.
- 4.9 In our original response, we also questioned whether HMRC would seize on the opportunity to open historic IR35 enquiries for low-paid workers. HMRC have confirmed in their briefing sheet¹ that they will not run any targeted campaigns such as this.² This is obviously also to be welcomed. However, we understand that following the recent ruling in the *Christianuyi* case,³ HMRC might be considering targeting such arrangements under the MSC legislation instead.⁴ This would seem to be on the basis that those providing hitherto exempt 'accountancy services' may actually now be caught as MSC providers (meaning that those using them are effectively managed service companies, whose income will be reclassified as employment income).
- 4.10 This is of huge concern to us, particularly as the low-paid workers we are concerned with will be those least likely to be able to deal with messy and potentially expensive compliance issues involving difficult and technical MSCs. Indeed, they probably will have had little choice or understanding as to what they were entering into in the first place!
- 4.11 The MSC legislation contains clear debt transfers provisions⁵ if the worker cannot meet the tax liabilities, which we would expect HMRC to invoke where appropriate. This would obviously not only help protect workers but could also have a deterrent effect. Appreciating

¹https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752074/IR35_web.pdf

² 'HMRC will not carry out targeted campaigns into previous years when individuals start paying employment taxes under IR35 for the first time following the reform and businesses' decisions about whether their workers are within the rules will not automatically trigger an enquiry into earlier years.'

³ <https://www.gov.uk/government/publications/spotlight-32-managed-service-company-legislation-tax-avoidance-scheme-involving-unpaid-payee-and-class-1-national-insurance-contributions/spotlight-32-managed-service-company-legislation-tax-avoidance-scheme-involving-unpaid-payee-and-class-1-national-insurance-contributions>

⁴ <https://www.qdoscontractor.com/news/2019/04/16/managed-service-company-legislation-rears-ugly-head>

⁵ <https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm5570>

that this point is related to the current consultation but not directly within the scope of the proposals, we would very much welcome the opportunity to discuss it further with HMRC separately.

5 Question 18 – Are there any other issues that you believe the government needs to consider when implementing the reform? Please provide details.

- 5.1 There are likely to be a large number of low-paid workers in PSCs caught up in these changes, due to there being less open, more complex supply chains (with less due diligence perhaps) in the private sector than in the public sector. In addition, it should be remembered that the changes from 6 April 2016 to the travel and subsistence rules meant that some umbrella companies encouraged their lower paid workers to incorporate. If they then claimed that their assignments were outside IR35, they could still continue to claim home-to-work travel and subsistence relief (despite anti-avoidance provisions).¹
- 5.2 However, there are often problems for low-paid workers in PSCs and while extending the IR35 public sector reforms to the private sector could in time help to remove the PSC ‘incentive’ (which we would applaud), we are hugely concerned about what impact the changes will have on workers already in PSCs.
- 5.3 These workers 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, such as an umbrella company, who can then save employer NIC and can also charge an ongoing fee for ‘accountancy’ services to help the worker run the PSC.² Even for a basic accountancy package, fees can be over £100 a month.
- 5.4 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, for example umbrella arrangements, as the money-making opportunity for the intermediary will be gone.
- 5.5 The first thing to say is that HMRC need to be aware that there are potentially very messy compliance issues stemming from the mass abandonment of PSCs. It is very cheap and easy

¹ By virtue of ITEPA s339A(4) 2003, workers operating through a personal service company are only able to claim home to work travel and subsistence relief for those contracts where they are operating outside IR35.

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

to open a PSC,¹ even when using a formation agent. Closing down a PSC, can definitely be trickier.²

- 5.6 Not only may there be costs involved for workers in terminating the relationship with the PSC accountant (particularly if they have signed up to pay for a ‘package’ of services on an ongoing basis), 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.
- 5.7 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 those of the PSC, and stand very little chance of closing down the PSC’s tax affairs correctly, let alone dealing with the Companies House requirements.
- 5.8 While our experience is that Companies House are really helpful in striking off a company, things can get complicated where a creditor or HMRC object to the striking off – which may well happen in these cases, if there are outstanding corporation tax issues. As such, we would like to see HMRC working with Companies House to come up with a way of making it as easy as possible for taxpayers to regularise any outstanding corporation tax issues and close down PSCs themselves, in conjunction with an amnesty for any accrued penalties.
- 5.9 Failure to put in place support for people shutting down PSCs who cannot afford advice is likely to mean that further burdens will be placed on the voluntary sector. The most likely place that workers will turn for help is to TaxAid,³ which may not have the resources to support all of those in need.
- 5.10 In terms of the types of arrangements that low-paid workers could be put in, in theory the only umbrella arrangements that should be around these days are those that are effectively just an outsourced PAYE bureau.⁴
- 5.11 In reality however, shortcomings in the way the authorities, particularly HMRC, have policed umbrellas and implemented changes to the system mean that this is not the case. For example, we are aware of the following non-compliant umbrella company models currently in operation for low-paid workers:

¹ <https://companieshouse.blog.gov.uk/2019/01/15/the-cost-to-set-up-a-limited-company/>

² <https://www.gov.uk/strike-off-your-company-from-companies-register/close-down-your-company>

³ <https://taxaid.org.uk/>

⁴ As explained in our factsheet:

<https://www.litrg.org.uk/sites/default/files/Umbrella%20factsheet%202018.19%20FINAL.pdf>

- 5.11.1 Travel and subsistence models – the rules were changed with effect from April 2016 by virtue of ss 339A¹ and s289A² ITEPA 2003, which together mean the exploitation of the tax/NIC-free travel expenses rules should no longer really be possible. But the rules in s289A do not apply to mileage reimbursements (they are not a part 5 ITEPA deduction but a part 4 ITEPA exemption). This means that umbrella companies can continue to process salary-sacrificed expenses at the point of pay where they are in respect of mileage reimbursements.³ Given the employer NIC saving that comes from doing this, it is unsurprising that we hear that some workers are being arbitrarily assessed by umbrella companies as being outside of their ‘supervision, direction or control’ in order to claim home-to-work travel relief and take full advantage of this loophole.
- 5.11.2 False self-employment – amendments were made to the agency legislation from April 2014⁴ to make it more difficult for umbrella companies to treat workers as ‘self-employed’, however we understand this is now starting to creep back into the landscape – particularly in the construction industry.⁵
- 5.11.3 Elective deductions model – created as a consequence of the April 2014 rules to deal with false self-employment amongst agency workers. Under this model, the individual is treated as an employee for tax purposes so that Pay As You Earn (PAYE) is operated as is required under law but treated as self-employed for all other purposes, meaning that they are not paid the minimum wage, not given paid annual leave, etc. This means that as far as HMRC

¹ From April 2016, Income Tax (Earnings and Pensions) Act 2003 (ITEPA) section 339A – Travel for necessary attendance: employment intermediaries – restricts access to relief for home to work travel and subsistence where a worker:

- personally provides services to another person;
- is employed through an employment intermediary (such as an umbrella company); and
- is under (the right of) the supervision, direction or control of any person, in the manner in which they undertake their work.

If the above apply, each engagement the worker undertakes will be a separate employment for the purposes of obtaining relief for travel and subsistence; that is the overarching contract is ineffective.

² Even where travel and subsistence expenses could still be allowed, for example because of multi-site visits or because the worker is outside the supervision, direction or control of any person, ITEPA section 289A – Exemption for paid or reimbursed expenses (also introduced from April 2016) – restricts the ways in which an umbrella company can reimburse a worker’s expenses. This is because the exemption only applies where the payment or reimbursement is not provided pursuant to relevant ‘salary sacrifice arrangements’, which most umbrella companies use.

³ HMRC also seem to have indicated that mileage reimbursements may fall outside of the Optional Remuneration Rules in certain circumstances: <https://www.prism.contractors/hmrc-clarifies-optional-remuneration-arrangements-and-umbrella-mileage-expenses/>

⁴ <https://www.gov.uk/government/consultations/onshore-employment-intermediaries-false-self-employment>

⁵ <https://unitetheunion.org/news-events/news/2018/july/construction-bogus-self-employment-rises-again/>

are concerned, everything appears to be in order. Operating such a scheme may save the business concerned money, but is unlikely to benefit the worker in any way at all.

- 5.11.4 Mini-umbrella companies – this model sees the formation of lots of individual companies, often with foreign nationals as directors. On the face of it, all is well as the worker will be having PAYE operated. However, in the background, workers are being put into mini companies, where surplus Flat Rate VAT¹ and the Employment Allowance are utilised to create an additional income stream for the intermediary. Despite an HMRC spotlight,² and media/press attention,³ we have just this month heard of someone in a mini umbrella company – the key giveaway is that each of their payslips had a different PAYE reference.
- 5.12 We continue to hear of general problems with ‘vanilla’ umbrella companies too. Here is one of the most recent queries that we have received to our website: *‘Hi, the Umbrella Company I am with make charges to process statutory payments such as my holiday pay or if I qualify for SSP. Are you able to clarify if they are allowed to do this?’* In this case, it is unclear whether these deductions are being made from gross pay (in which case they may well be ‘unauthorised deductions’) or whether they are wrapped up in the umbrella company margin and are coming off of the calculation before gross pay is arrived at. Whichever the case, we think such practices need to be investigated further.
- 5.13 Not only is a low-paid worker unlikely to understand what is happening with their pay and taxes in many of these situations (nor the knock-on effects that these arrangements can have on tax credit and universal credit claims), in all of them there could be substantial tax losses. Even under the elective deductions model, where PAYE tax is being paid, this type of arrangement must be impacting considerably on gross wage levels (through denial of otherwise taxable holiday pay, etc.) meaning lower receipts for the Exchequer.⁴
- 5.14 Other options available to intermediaries to help protect their profitability in the face of the private sector changes include the use of more zero hours/short hours contracts as a way of managing hours and keeping pay below the various thresholds at which different employer

¹ While new legislation was introduced from 1 April 2017 to restrict the Flat Rate VAT (FRV) rate for traders of limited costs, such as labour-only businesses, it is unclear as yet how far these new VAT rules are having the desired impact. In any case, there is still an advantage to entering the FRV scheme, in that new businesses receive an additional 1% reduction in their first year of trading.

² <https://www.gov.uk/government/publications/spotlight-24-employment-allowance-avoidance-scheme-contrived-arrangements-caught-by-existing-rules/spotlight-24-employment-allowance-avoidance-scheme-contrived-arrangements-caught-by-existing-rules>

³ For example, see <https://www.bbc.co.uk/news/business-32914372>

⁴ See explanation in para 6.5: <https://www.litrg.org.uk/sites/default/files/files/170224-LITRG-response-Commons-select-committee-tax-base-FINAL.pdf>

obligations are triggered.¹ Although there is no wrongdoing here as such, there are potential knock on consequences – one of which is that workers could be living on such precariously low wages that there will be more reliance on in-work benefits. Thus, there may be an overall cost to the public finances from this type of work.

- 5.15 The government hopes that the changes to the off-payroll working rules will help secure funds of up to £1.3 billion a year. However, this seems unlikely given what we have said above and if headlines such as *Revealed: temp agencies' tax avoidance scheme costs 'hundreds of millions'*² are to be believed (this article is referring to the mini-umbrella company scam).
- 5.16 As with the original consultation, little thought seems to have been given in this consultation to what impact the changes in the private sector might have on low-income workers in PSCs and what the reaction of the temporary worker market will be.
- 5.17 We hope we have demonstrated why this is short-sighted and why it is paramount that HMRC think holistically and take action to clamp down on non-compliant umbrellas before the IR35 reforms take place. As always, we are happy to discuss any aspect of our response in more detail if that would be helpful.

LITRG

28 May 2019

¹ For example, if workers' earnings can be kept below £166 a week, Class 1 secondary National Insurance at 13.8% can potentially be avoided. If workers' earnings can be kept below £192 a week, contributions into their pension scheme under auto-enrolment can also potentially be avoided.

² <https://www.theguardian.com/uk-news/2016/nov/15/revealed-temp-agencies-avoidance-scheme-costs-taxpayers-hundreds-of-millions>