

**Onshore employment intermediaries: false self-employment
Response from the Low Incomes Tax Reform Group ('LITRG')**

1. Executive summary

- 1.1. We welcome the opportunity to respond to this consultation as we share concerns about the growing use of models of engagement designed to avoid the fiscal obligations of being an employer.
- 1.2. We are pleased that preventing the exploitation of low-paid workers seems to be at the heart of this consultation as this supports our own understanding that the rise in the type of false self-employment outlined in the consultation document can be largely attributed to the influx of vulnerable migrant labour from Eastern Europe; particularly from Romania and Bulgaria – whose nationals, because of the employment restrictions, have had little choice but to come as self-employed if they want to enter the UK to work.
- 1.3. However, we can envisage the policy itself and draft legislation causing both practical and commercial difficulties for those in the labour supply chain. Our overriding concern is that it will be the low-income worker who will bear the brunt of the fall out.
- 1.4. There is a sense that these proposals are being rushed through and as the key for whatever course of action is decided upon is to avoid ambiguity, we would urge a proper period of analysis and evaluation as another narrowly targeted set of rules that address only part of the problem, may only serve to undermine the Government's overall efforts here.
- 1.5. We would like to propose a combination of measures as an alternative way forward – addressing the complex underlying rules that breed the endless 'planning' opportunities, more effective and efficient HM Revenue & Customs (HMRC) compliance action that makes an example of the aggressive scheme purveyors and, finally, better communications with the public, not only about the risks of entering into 'schemes' but also to HMRC's approach to tackling it so as to restore confidence in the system.

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 HM Revenue & Customs 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.
- 2.4. Our response supplements that of our CIOT colleagues, which we are very happy to endorse fully.

3. General comments

- 3.1. We welcome the Government's commitment to tackling areas of the tax system where distasteful behaviour is widespread. With the costs and obligations of employment ever rising, increasingly we are seeing abuses involving phoney self-employment. Emphasis on the UK's flexible and adaptable workforce mean that all kinds of 'staffing solutions' providers proliferate. The recent past has seen an increase in schemes combining the two things and unfortunately it is low-income, typically migrant workers, who are disproportionately affected. We are therefore responding to this consultation document from their perspective.
- 3.2. As the consultation document points out, false self-employment was initially a problem within the construction industry where the first scenario, as illustrated on page 11, was commonplace. The UCATT report, *The Great Payroll Scandal*¹, provides some insight into how payroll companies operate in the construction industry and details how construction workers are often given no choice but to work through a payroll company in order to get work. We suppose that the report has been very useful to the Government in terms of understanding this problem.
- 3.3. More recently, we are aware that false self-employment has spread to what we might call 'temping jobs' – where self-employed waiters and waitresses and factory workers are the norm. While we are certainly aware of the problem, we cannot comment on the scale of it. We would, therefore, be interested in the 'increasing evidence' that the Government has collated on this.

¹ <http://www.ucatt.org.uk/reports>

- 3.4. The particular model that we are aware of involves contrived arrangements in which a fourth body is inserted in the labour supply which essentially disrupts the operation of the 'agency legislation'. This fourth body is not a personal service company (PSC) of the worker, which would 'allow' a gross payment from the agency to the company as outlined in ESM2017 (but which brings with it all the attendant PSC considerations). Instead it is an 'umbrella' company to which the worker provides his services in a self-employed capacity. The company makes the contract with the agency, so that there is no 'agency contract' between the worker and the agency and there is no 'agency contract' between the umbrella and the worker, as the contract contains a substitution clause. As is stated in ESM2011 (footnote to be added):

'Where it is found that the contract includes a genuine and unfettered right of substitution i.e. there is no obligation on the worker to personally provide services to the client, then the contract will not meet one of the required conditions for the agency legislation to apply. The contract will not be an agency contract as defined in section 47(1) and the condition at section 44(1)(b) will not be satisfied. Where this is found to be the case then remuneration receivable by the worker under the terms of the contract will not be treated as earnings chargeable to tax as employment income, the worker will not be treated as an employed earner for Class 1 NICs purposes and the agency/third party will not be treated as the secondary contributor for Class 1 NICs purposes.'

- 3.5. The workers are paid gross without needing to work through a PSC. They can also claim tax relief on their expenses. However, the workers lose out on various employment law rights conferred on 'normal' agency workers, are often obliged to pay a fee to the intermediary for setting up the position and do not have the certainty of their tax and NIC being dealt with via PAYE.
- 3.6. In addition, they might not understand, or be able to deal with the costs and consequences of having to register for Class 2 NIC or filing a self-assessment personal tax return each year, risking a compliance investigation by HMRC into their affairs later on. Worryingly, we have seen an example of a 'self-employed umbrella' withholding amounts from gross payments in respect of Class 2 and 4 National Insurance contributions and income tax liabilities in order that the client can be 'assisted with budgeting'. In this particular case, the worker, a Romanian national, had no idea that this was not the usual course of action and did not question it – until it came to tax return filing time and it transpired that the agency had not remitted the sums in question to HMRC.
- 3.7. Our response supplements that of our CIOT colleagues, which we are very happy to endorse fully.

4. Question 1: Would the definition of intermediary as proposed in the draft legislation cause any practical difficulties, e.g. to genuine commercial arrangements? Please provide details and examples.

- 4.1. Some contractor and recruitment industry respondees will no doubt comment that the proposals are unclear and could be quite far reaching so as to 'catch' those in genuine self-employment. The concept of 'false self-employees' may be causing many of them to have flashbacks to 'disguised employees' and the IR35 fiasco and it would be unwise for the Government not to pay attention to the oral and written evidence given recently to the

House of Lord PSC select committee (essentially on the effectiveness of IR35) while considering their options for dealing with the particular matter in front of them.

4.2. Other practical issues may be raised around the compliance requirements and administrative burden of such, as well as the difficulties of proving abstract concepts such as control, direction, supervision. No doubt the relevant stakeholders will apprise you of their concerns forcefully and further comments from us on these issues are therefore superfluous. However, we would like to state that we are disappointed in the short time frame given to respond to what is a very important consultation, the eight weeks of which take in Christmas and New Year and also January – the busiest time for many tax professionals who may not feel that they have had a decent time to digest a 54 page document on both policy *and* legislation, establish whether they have an interest and what that interest might be and to respond to the consultation in any meaningful way.

4.3. While recognising that the Government wants to legislate quickly, we suggest that more time is taken to consider whether the proposals do actually hit their mark, whether they can be interpreted without confusion and the need for lengthy guidance and more case law in this area and what the wider implications are in more detail.

5. Question 2: Are there likely to be any commercial difficulties with the proposed definition of employment intermediary? If so, please say what they are likely be and provide examples.

5.1. These proposals have varying implications depending on whether seen from the perspective of the self-employed umbrella, the temping agency, the end client, the worker, in the construction industry or outside. While we might share some concerns about the commercial difficulties that other entities in the chain of supply may face, and the effect that these will have on the labour market for example, our preoccupation with the position of the low-paid worker takes precedence. As such we would like to make some high level comments on the likely business reaction to these proposals and what the unintended consequences might be, for the taxpayers caught up with them.

5.2. *Likely employer reaction*

5.2.1. One of our main objectives is to investigate new proposals to see what impact they may have in terms of employer response and to what extent low-income workers will bear the brunt of any fallout.

5.2.2. The strengthened legislation will mean that extra costs of 13.8% will be borne by the intermediary. They will also be responsible for administering the PAYE and RTI and paying holiday and statutory payments. We cannot imagine that such an increase in costs will be absorbed by the business; therefore the costs are likely to be borne to a significant degree by the low-income worker themselves in the form of lower hourly rates or spurious fees/charges.

5.2.3. It is very likely that workers will be worse off as a result of this. In fact, this, coupled with the reduction in their take home pay as a result of income tax and employees' NIC being deducted at source, could see their position deteriorate rapidly. If that were to happen, any decrease in net pay could result in an increase in means tested benefit entitlement, including Universal Credit, and we are interested in how the Government views this.

- 5.2.4. One of the other probable scenarios, on the basis that these business models have been dependent upon supplying the labour at a smaller mark-up than their competitors, is that the commercial advantage will be lost and they will shut up shop. With many other types of PAYE avoidance schemes out there, employees will just be pulled into other arrangements, such as Payday by Payday (which despite best efforts still seem to persist), PSCs and so on (see our response to the consultation document on 'Lifting the lid on tax avoidance'²).
- 5.2.5. While we agree that no longer suffering a weekly charge by the intermediary will ameliorate the worker's position, much is made of the other elements that would help restore their financial situation, such as gaining entitlement to employee rights. However the problem is not straightforward, as we explain below.
- 5.2.6. The proposals are essentially to *deem* agency workers as employees for tax purposes unless they can show they are not under control, direction or supervision and can provide evidence of this.
- 5.2.7. Leaving aside the impossibility of proving a negative, the consultation document seems to assume³ that if you are employed for tax purposes, then you are employed for employment law purposes and this is not always the case. While the consultation document does go on to say '... although this will depend on them being within the case law tests set by the courts ...' it could be much **clearer** that employee rights will only come into play when the workers are, in fact, employed in a legal sense. It is barely possible for a low-paid worker to understand and enforce their rights at the best of times and this just serves to confuse the matter further.
- 5.2.8. In fact, most 'normal' agency workers may well be treated as employed for tax purposes but are *workers* for employment law purposes, which means that they have some employment rights, including paid annual leave, rest breaks and limits on working times, the National Minimum Wage, no unlawful deductions from wages, discrimination rights under the Equality Act 2010 and health and safety at work – but not all. Another point is that employment law status (like tax employment status) depends on the true underlying nature of the relationship between the parties involved, and it seems to us that if the 'self-employment' being presented is actually a sham, then the worker is a 'worker' for employment law purposes anyway and nothing additional is being conferred here. Whether the workers have the ability or wherewithal to be able to claim their 'worker' rights and protections is another question; however, in our minds, the 'benefits' of paying PAYE tax and Class 1 NIC for the worker, are somewhat overstated in the consultation document.
- 5.2.9. In addition, while we do accept that some agency workers may become entitled to the same or no less favourable treatment as comparable employees with respect to basic employment and working conditions, if and when they complete a qualifying period of 12 weeks in a particular job under the Agency Worker Regulations legislation, the Government will be aware that many mechanisms exist, e.g. Swedish derogation or pay-between-assignments contracts, that essentially deny the agency workers this opportunity and present a whole

² <http://www.litr.org.uk/submissions/2012/lifting-the-lid-on-tax-avoidance-schemes-litr-response>

³ 'In the majority of cases the worker will also gain the benefits of being an employee for employment rights' - page 26.

range of different issues to the worker (not least that often they are only guaranteed one day's work a week and there is rarely any 'pay-between-assignments'). While we also accept that statutory payments may become payable due to there being a secondary NIC contributor, it is not at all straightforward for agency workers to meet the qualifying conditions, particularly with regards to the 26 weeks continuous employment condition for Statutory Maternity Pay.

5.2.10. In summary, while much may be made of the workers' out-of pocket-position being bolstered by the benefit of various employment rights, these may be illusory and, even if they are not, the workers are very likely to be living from one day to the next focused on their net cash pay, and so they may not *feel* better off. It could follow in an extreme case that the effect of gathering more revenue from some of the lowest earning workers will be that some may conclude that reverting to state benefits will give them a better standard of living.

6. Question 3: Do you have any general comments on the legislation as drafted and if it will achieve the stated policy objectives? If so, please provide reasons.

6.1. We would refer you to a previous consultation document response in which we comment on another set of 'deeming proposals', in the context of 'False self-employment in construction'⁴ and we reiterate those comments as far as they are relevant to these proposals.

6.2. Again – we are concerned that the Government is oversimplifying the matter of employment and self-employment. While many temporary or casual workers would relish a secure and permanent employment, unfortunately irregular and insecure work is their norm – they are just not part and parcel of *any* business engaging them. The nature of the engagements and relationships within them are, therefore, often complex and the proposals do not seem to make a distinction between engagements, which do have the characteristics of self-employment (albeit some will be borderline) and to those phoney arrangements where engagers hold workers out as self-employed in order to save themselves costs.

6.3. There is a big difference between the two and the Government does not seem to be framing their response to each one appropriately. For example, in para 2.6 on page 10 of the consultation document, the Government explains how the test of the worker being obliged to provide their services is being exploited. It explains that the intermediaries, who are the focus of this consultation, attempt to sidestep this test by claiming that there is no obligation for the worker to provide their services personally: *'This may be done by including a clause in the contract that states the worker is able to send someone else to do their work. In fact this is often not the case because in reality the engager wants that specific worker.'*

6.4. This sounds like a clear case of evasion to us, which would indicate that appropriate and robust compliance action is what is needed rather than legislation to close any 'loopholes'. HMRC does go on to say that in such cases it can be difficult for them to prove that the reality of the worker's situation is different from that presented in the contracts. We sympathise with HMRC that compliance work is difficult and costly. But this does not mean that it should not be undertaken where appropriate.

⁴ <http://www.litrg.org.uk/NR/exeres/AC83E6BB-93E8-4CA6-B3D6-FD365441390E>

- 6.5. If HMRC do not have the resources to police the activity of engagers then this is another matter. However, why then do HMRC compliance officers spend time and resource undertaking reviews of labour-only subcontractors' tax returns, not with the aim of picking up on the possibility of employment status reviews with the engagers (as one might expect) but rather to seek assurances about the validity of their business expenses? Surely a more effective use of limited resources would be to tackle the problem at its source by challenging those who operate the schemes.
- 6.6. Finally, HMRC should, in our view, do more to test the problem of self-employed agency workers in the courts before rushing these rules on to the statute books. While HMRC may have only enjoyed limited success in seeking reclassification of construction workers, this may be because such cases often involve skilled, experienced tradesmen who do not need control, supervision or direction so their status' can be open to interpretation. This calls us to question whether the proposed legislation will be effective in respect of this subset of workers, and suggests that legislating for cases involving unskilled workers outside of the construction industry may be premature. Instead, HMRC should arguably refocus on strong investigations and prosecutions that really send a message out to businesses who may be thinking of engaging in schemes of this nature.
- 7. Question 4: Is the interaction with IR35 likely to cause any issues? If so please state what they are likely to be.**
- 7.1. The interaction between these proposals and existing tax legislation such as IR35 or that put in place to deal with Managed Service Companies is outside the scope of our work so we have no comments.
- 8. Question 5: Would ensuring the intent of this legislation is maintained, such as with a TAAR, be helpful in preventing attempts to avoid this legislation?**
- 8.1. We support, in principle, any measures to tackle the exploitation of vulnerable, low-paid workers. However, if there are concerns about potential scenarios where people may seek to avoid this strengthened legislation, then we would like to point out that the underlying rules are themselves part of the problem. A whole industry has developed around exploiting the fault lines in the UK tax system, tax and NIC, employment and self-employment, not to mention the distinction between temporary and permanent workplace. Overly complex and constantly changing laws breed endless planning opportunities and a wholesale re-thinking of the entire code is called for.
- 8.2. We appreciate that this is not the easy way out. However, in our view it would be better for the Government to work at a more long-term, sustainable goal – reducing or eliminating the incentive to present an engagement as one of self-employment rather than employment.
- 8.3. We would like to propose in the meanwhile that HMRC do their utmost to try and educate the workers as to the inner workings of the temporary labour market and the consequences for them of using one 'scheme' over another. Lack of help and information from HMRC leaves many workers unaware of the risks associated with 'schemes' or even how they operate on a basic level.
- 8.4. A one-size fits all approach to communication will not work as not everybody has the same capacity. Clear, user-friendly, targeted consumer messages will be required at the less

sophisticated end of the taxpayer spectrum. HMRC must also ensure that guidance is available through more than one channel. We should be happy to discuss our ideas and offer our assistance with this.

- 8.5. A basic understanding of the risks and the consequences of avoidance and evasion for the tax system as a whole will equip taxpayers (and end clients) with better possession of the facts, enabling them to exercise some choice over which entities to engage with and which not. Interestingly, the worker referred to in our opening remarks in para 3.6 with the Class 2 and 4 NIC problem was not a low-paid worker at all, but a Romanian doctor locuming in the NHS through a medical agency. Even she, an educated, professional taxpayer was unable to navigate the complexities of our UK tax system so as to prevent herself being caught up in a mess.

9. Conclusion

- 9.1. While tax law (and employment law) is so complex and uncertain, there will always be people ready to take advantage of that. The piecemeal approach to tackling this is not working.
- 9.2. Therefore, our conclusion is simply to call for a thorough review of the underlying rules, which breed endless dark and confusing practices, and to state that, in the meanwhile, better information will produce the benefit of greater understanding and certainty for the tax payer as to their positions and any tax problem they may face. Therein lies the best protection for the low-income worker.

LITRG

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