

Commons Select Committee
Further call for evidence for UK tax policy inquiry
Written evidence from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

- 1.1. We welcome the opportunity to respond to question one in this call for evidence.
- 1.2. We are a group of tax specialists with expertise in the tax and related welfare issues of the low-paid. We run four websites¹ through which people contact us describing their problems with tax, National Insurance and tax credits. Often these problems have arisen in the context of non-standard flexible forms of employment such as agency work, zero-hours contracts and self-employment. And often they expose issues that we think could be a threat to the tax base. As such, we thought it would be useful to make a submission to this inquiry looking at some of this evidence in more detail.
- 1.3. In terms of the specific question before us, ‘how big is the threat to the base...’ we have not tried to quantify this ourselves, however we note the release of several reports recently that do, including that of the Trade Union Congress (TUC)². While we cannot confirm their headline figures of £4bn a year absolutely, what we are seeing in our work would tend to support their analysis of the situation and thus lead us to draw our own conclusion that the threat to the tax take from changing patterns of work is ‘big’.
- 1.4. For example, the TUC say that the growth of low-paid self-employment and zero-hours contracts has led to a fall in government revenues because those in low-paid self-

¹ www.litrg.org.uk, www.taxguideforstudents.org.uk, www.disabilitytaxguide.org.uk and www.revenuebenefits.org.uk

² <https://www.tuc.org.uk/industrial-issues/workplace-issues/rise-insecure-work-costing-exchequer-%C2%A34bn-year-warns-tuc>

employment and on zero-hours contracts earn significantly less than regular employees and therefore pay less tax and National Insurance. While it must be acknowledged that some of this will be down to the Government's programme to raise the personal allowance, we gain the general impression from those who have contacted us, particularly workers on zero-hours contracts, that they are indeed living on precariously low wages. Further, as gross low wages can lead to potentially more reliance on in-work benefits, an overall cost to the public finances from this type of working seems very likely.

- 1.5. From what we have seen from those contacting us, coupled with the gathering body of work in the area, it seems that much of the recent growth in self-employment, particularly 'freelancers' in the gig economy, is amongst those who are young, unskilled or migrant workers. Yet the self-assessment tax return system is very complex – and these groups of people are perhaps least likely to be able to navigate it.
- 1.6. We agree with the TUC, and indeed the Institute for Fiscal Studies (IFS) who have also recently looked at this issue,¹ that differences in the treatment of self-employment income and employee earnings in the tax and National Insurance system will be contributing to the 'fiscal gap'. However, this assumes that individuals are paying tax in the first place and considering our points above, we raise the possibility of another threat to the tax base from the growing numbers of self-employed: that of non-compliance or under reporting.
- 1.7. No discussion of non-standard work would be complete without a mention of agency workers. A recent Resolution Foundation² report puts the number of people doing agency work at 865,000. They also talk of an average pay deficit of £430 per worker per year (between agency workers and their non-agency counterparts). These two things taken together, if accurate, would represent a significant issue for the Exchequer.
- 1.8. If this was not enough of a problem, we think a further threat to the tax base exists due to recent shifts in the way in which temporary work agencies and other intermediaries engage their workers. Following changes to rules around claiming travel and subsistence costs in April 2016, such businesses are now asking people to work through their own limited companies, for example. The point here is that when Government targets particular abuses, those affected generally find some other way to protect their profitability and this often leads to the tax base being threatened by other, different kinds of abuse.
- 1.9. Finally, we would like to highlight that very low or irregular earnings patterns year-on-year could be affecting people's ability to build a National Insurance record for state pension purposes. Not only does this mean that such workers (and employers) do not pay National Insurance, often earning below the relevant threshold in multiple jobs, it also means that they are also likely to be unwittingly heading towards an uncertain retirement – and one reliant on means tested benefits.

¹ <https://www.ifs.org.uk/publications/8872>

² <http://www.resolutionfoundation.org/publications/secret-agents-agency-workers-in-the-new-world-of-work/>

- 1.10. The lack of building entitlement to state pension is further compounded by the same workers falling beneath the threshold for automatic enrolment into workplace pensions, so missing out on employer contributions and failing to amass any private pension. This is a perhaps a more hidden cost of the move towards flexible labour but should be borne in mind when assessing the threat to the tax base.

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 (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 Introduction

- 3.1 We are a group of tax specialists with an interest in the tax and related welfare issues of the low-paid. We run four websites¹ to which people write describing their problems with tax, National Insurance and tax credits – often these have arisen in the context of non-standard ways of working.
- 3.2 The queries we see suggest various issues, including: precariously low earnings for workers on zero hour contracts; potential non-compliance in the case of self-employment; and widespread PAYE avoidance behaviour in the agency worker arena. While the tax base has been shrinking amongst low-paid workers anyway due to the Government's programme of raising the personal allowance, it seems to us that such working arrangements *must* be further impacting on tax and National Insurance receipts.

¹ www.litrg.org.uk, www.taxguideforstudents.org.uk, www.disabilitytaxguide.org.uk and www.revenuebenefits.org.uk

- 3.3 As such, we wanted to make a submission to this inquiry looking in detail at some of the email correspondence we have received from users of our websites.
- 3.4 We hope this evidence will be useful input for question 1: 'How big is the threat to the base for income tax and National Insurance from the changing patterns of working (for example increased levels of multi-jobbing and self-employment and different ways of working, to which the Chancellor referred in his Autumn Statement)?'

4 Zero-hours contracts

- 4.1 A recent report by the TUC¹ aims to estimate the size of the 'fiscal gap' which occurs due to increased levels of 'insecure' work – i.e. those working without guaranteed hours or baseline employment rights. We do not reiterate the detail of that report here, but to be helpful, summarise parts of it where appropriate.
- 4.2 The report uses tax and benefit modelling to show the impact of the growth in insecure work since 2006. They put the negative impact of increased self-employment and zero-hours contracts on the public finances at around £4bn a year. This impact has three components:
- Low-paid self-employed workers and those on zero-hours contracts earn significantly less than regular employees and therefore pay less tax and National Insurance;
 - This also makes them more likely to need to rely on in-work benefits such as tax credits and housing benefit;
 - Even when the self-employed do earn as much as regular employees, the tax is structured so that they pay less.

While we will cannot comment on the actual figure of £4bn arrived at, queries that we have seen highlight to us that people on zero hours contracts, for example, are indeed living on precariously low wages. Thus we have little trouble generally agreeing with bullet points one and two.

- 4.3 By way of an illustration of this, an enquirer writes: *'I'm a care worker. My contract is zero hours, basic pay £6.53ph + 0.67ph holiday pay. The job advert specified a car was required. In the induction we were advised petrol costs would be covered by HMRC under the P87 system; however, this will not materialise as we earn under the taxable limit. In 13 weeks I have paid out over £250 for travel to clients but I will never receive any reimbursement for petrol costs. I'm using my credit card to pay for fuel.'*

¹ <https://www.tuc.org.uk/industrial-issues/workplace-issues/rise-insecure-work-costing-exchequer-%C2%A34bn-year-warns-tuc>

- 4.4 This enquirer wrote to us in 2013 when the taxable limit (income tax personal allowance) was £9,440.¹
- 4.5 Another enquiry reads: *'I am a graduate worker and am new to this tax system. My tax code is 944L. My employment is on a zero hour contract and work varies day to day for me. At times if there is no work I get paid very little. When I checked my wage slips I am only paying national insurance and no PAYE tax. Please help me as this confuses me, I am not sure if this is correct.'*
- 4.6 From this we can deduce that even in weeks of work, this *graduate* is earning less than £182 per week (although more than £149). We wonder about the times of 'no work' that she alludes to.
- 4.7 Furthermore, the example below is just one of many such enquiries about eligibility for tax credits that we receive every week. Many people in non-standard work rely heavily on in-work benefits – a less direct, but nonetheless significant cost to the economy of flexible forms of employment:

'I am currently employed on a zero hour contract & know I will have little income jan - march. I sell my own stuff on ebay and want to start a small ebay selling business. I currently get wtc (about £60) and ctc as I am a single mum of 2.²I would just like to know how I stand with the tax credits. I think I am only going to get something like 4-8 hours a week at my employer jan - march so aim to work for myself perhaps 20. From march I go back to my original employer where I am a permanent seasonal worker with a 15 hour contract getting roughly 24 hours a week. Sounds confusing ... thats my life!!!' [sic]

5 Self-employment

- 5.1 We also agree with the TUC and indeed the IFS³ who have also recently looked at this issue, that differences in the treatment of self-employment income and employee earnings in the tax and National Insurance system will be contributing to the 'fiscal gap'.⁴
- 5.2 However we think there is another threat to the tax base in the rise in self-employment. It seems to us that a great number of those turning to self-employment to make ends meet,

¹ The enquiry also suggests there may be a problem with the National Minimum Wage (NMW) rules and being paid for travelling which will be eroding her gross wages. While there are complexities in the NMW rules to do with travelling we would like to point out that non-compliance with the NMW is not the same 'problem' as zero hour contracts and is within HMRC's power to do something about.

² wtc and ctc are Working Tax Credit and Child Tax Credit.

³ The IFS conclude that self-employed people enjoy more beneficial tax treatment to the tune of £1,240 per self-employed person, per year:
https://www.ifs.org.uk/uploads/publications/comms/R124_Green%20Budget_7.%20Tax,%20legal%20form%20and%20gig%20economy.pdf

⁴ Differences include that self-employed pay lower National Insurance contributions than employees and can also deduct more by way of expenses.

particularly those in the gig economy, are young, are unskilled, or have lower levels of education or are migrant workers with limited English. Many will not usually have had to fill in a tax return before and are unlikely to engage an accountant or tax adviser.

- 5.3 As a consequence, these individuals have to navigate the complexities of the confusing self-assessment system on their own, which may well result in non-compliance or under-reporting. We think this is all the more likely considering the introduction of the £1,000 tax free 'trading allowance' in April 2017¹ which – although welcome in many respects – risks giving out mixed messages about gig economy income.
- 5.4 Furthermore the difficult terms and conditions that some of those working in the gig economy may find themselves under should be noted when thinking about the tax base. The financial pressure and disenfranchisement the writer below hints at, must make retreating into the hidden economy seem quite tempting:

'I am a "self employed" owner driver for a parcel delivery company. I own my own van and pay relevant insurances and fuel. I have a 2 year contract to deliver and collect parcels in a designated area. Until now we have been allowed to work away under our own steam. "New delivery rules" are being implemented which means i am now being told where to go and when, no matter the personal cost in excess fuel and time it will take me. I.E. it may take 1 extra hour and 20 extra miles to do the same route as i do now. I am financially penalised if i miss a time window. Their own drivers are not. There is no pay increase or payment to compensate this. I am now expected to do the same job as their own employed drivers without any worker rights. No sick pay, holiday pay or workplace pension like their own employees. My contract has not changed since i signed it. I never had any say in the contract...it was given to me with no negotiation. If i did not sign it i could not work. I have been told i must fulfill my contract but i feel like i am being treated as an employee. There are several of us in this situation and we dont know where to turn. Please help!!!' [sic]

6 Agency work

- 6.1 A recent report by the Resolution Foundation,² suggest that the number of agency workers has grown by 30 per cent since 2011, and now stands at 865,000.

¹ The new allowance will mean that an individual who has income from one or more trading businesses which does not in aggregate exceed £1,000 for a tax year will have no tax liability on the profits from that business. Where such annual income does exceed £1,000, the individual will have the option when calculating their taxable profits of either deducting all their actual business expenses (in the usual way) or of deducting the fixed allowance of £1,000 (regardless of their level of actual business expenditure).

² <http://www.resolutionfoundation.org/media/press-releases/britain-is-on-track-for-a-million-agency-workers-by-2020/>

6.2 The report highlights that, all else being equal, a full time agency worker earns £430 year less than an identical employee in the same role. These figures taken together, if true, would clearly be affecting the tax base.

6.3 In our view, recent changes in the agency worker sector may also pose a threat. Since new rules in April 2016 essentially closed down the ability for agency workers working through an umbrella company to get relief for their travel and subsistence expenses, agencies are simply adopting different approaches to engaging their staff, including asking workers to work through their own limited companies. The point here is that when Government targets particular abuses, those affected generally find some other way to protect their profitability and this often leads to the tax base being threatened by other, different kinds of abuse.

6.4 ***Use of limited companies***

6.4.1 Personal Service Companies (PSCs) that fall outside 'IR35' are not caught by the new travel and subsistence rules. This has resulted in many workers being told they must provide their services through their own company¹ as we can see from the beginning of this recent query:

'Dear Sir/Madam, I work for an agency called AA. They work with a company called XX which provides the payroll for their agency workers. When I was hired by AA I had to register with XX in order to be paid. By registering with XX, it meant having to register as a limited company, despite solely working for AA...'²

6.4.2 Where PSCs are used, not only does this allow for travel and subsistence claims against tax, but directors can structure their remuneration more tax efficiently than employees, meaning individuals are likely to be paying much less tax than their directly employed counterparts.

6.4.3 Perhaps more worryingly from a revenue perspective, and in a similar vein to our comments in paras 5.2 and 5.3 about the self-employed, is the fact that the responsibilities and obligations associated with running a limited company mean they are often totally inappropriate for workers, leading to non-compliance and yet more revenue losses for the economy.

6.5 ***Elective deductions model***

6.5.1 We have recently received this email:

'hi im after a little advice please, i am classed as self employed..i think, i work for a sub contractor in the XX delivery network as a delivery driver, in about august my route got took over by a new sub contractor who i now deliver for, my wages used to be paid directly to me by my old employer who did not deduct any tax and ni and i had to sort that out which was fine, i didnt have any holiday pay pension sick pay etc which i accepted as i was self

¹ Many arrangements involving PSCs will in fact be caught by the travel and subsistence rules; the businesses are probably just relying on the fact that HMRC has a poor track record of IR35 compliance.

² We have redacted the business names

employed, now this new company i work for use some sort of company called YY who pay me my wages with tax and national insurance deducted so it seems i am employed but with no benefits ie no pension holiday pay etc my question is are they allowed to do this basically am i employed or self employed as i keep getting told different things by my friends many thanks¹
[sic]

- 6.5.2 This person is working under the ‘elective deduction model’. Under this model, the individual is treated as an employee for tax purposes so that PAYE is operated as is required under law, but treated as self-employed for all other purposes. This means that they are not paid the minimum wage, not paid parental or sick pay and not given paid annual leave, etc.
- 6.5.3 Such treatment will be generating cost savings for the businesses but benefiting the worker in no way at all. Moreover this type of arrangement must be impacting considerably on gross wage levels, meaning lower receipts for the Exchequer.

6.6 **Short hours**

- 6.6.1 We also understand anecdotally that short hours contracts (20 hours or less per week) are now being used throughout the agency worker industry.
- 6.6.2 Potentially this means that we will see more multi-jobbing. However, the fact that National Insurance contributions (NIC) liabilities are calculated totally independently from each other and are not compared to an overall annual amount, like for tax, means that keeping gross weekly wages below the relevant threshold of £156 (which at 20 hours x the minimum wage they would be) helps employees – and businesses – avoid National Insurance.
- 6.6.3 It is worth noting that this tactic is also used by businesses as it keeps the worker below the auto enrolment threshold (which is also applied per job²). To this end, we would urge the Committee not to lose sight of the fact that Government’s own policy making can have an impact on the shifting tax base as well as rapidly changing work practices.

7 **Lower Earnings Limit (LEL)**

- 7.1 In section 4.7 we looked at an illustration of how non-standard work seems to go hand-in-hand with a higher reliance on in-work benefits – a less direct, but nonetheless significant cost to the economy of non-standard work.

¹ We have redacted the business name

² Employers must automatically enroll all staff who are: aged 22 to state pension age, working in the UK – under a contract of employment (OR under a contract to provide work or services that you cannot delegate to someone else) and earning over £10,000 a year (2016/17), which translates to £192 weekly.

7.2 Taking this one step further however, we suggest that for a good number of people, low, potentially fragmented earnings mean that they will not actually be meeting the LEL¹ and so may not be building a National Insurance record for state pension purposes:

7.3 An enquirer to our website writes:

'Hello I have two jobs both individually below the LEL for National Insurance contributions (one is an apprenticeship). So I don't pay NIC on either earnings but added together it is more than the LEL. Should I ask one of my employers to pay or contact HMRC? Thanks'

7.4 This worries us a great deal. As well as having an uncertain working life, people in non-standard work could be unwittingly heading towards an uncertain retirement (particularly when coupled with the likelihood that no private pension will be accumulated due to missing out on automatic enrolment as noted in 6.6.3 above) – one reliant on means tested state benefits. This is another, albeit, more hidden cost, of the rise in non-standard work and should be borne in mind when assessing the threat to the tax base.

LITRG
24 February 2017

¹ As of 2016/17, the LEL is £112.