Response from ICAS

HM Treasury and HM Revenue & Customs
Off-payroll working in the private sector

10 August 2018

About ICAS

1. The following submission has been prepared by the ICAS Tax Board. The ICAS Tax Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 board and committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

2. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members into the many complex issues and decisions involved in tax and financial system design, and to point out operational practicalities.

General Comments

3. ICAS welcomes the opportunity to respond to the consultation document 'Off-payroll working in the private sector', issued by HMT and HMRC on 18 May 2018. We were also pleased to host a meeting, and attend other meetings, with officials to discuss the consultation.

4. HMRC has been keen to reassure round table participants that no decisions have been taken by ministers on how, or whether, revised regulations should be incorporated into the private sector IR35 regime, including on timing. ICAS is supportive of this stance because the introduction of the public sector regime has proved problematic and the private sector is an altogether more complicated affair with numerous considerations which are not inherent in the public sector.

5. It is clear from representations made to us by members that, in spite of the assertions made in both the independent report and HMRC factsheet, the new public sector IR35 regime has impacted both private and public sector labour market in terms of flexibility and depth of the recruitment pool for project-based engagements. The introduction of a revised regime in the private sector will undoubtedly also further influence that already in place in the public sector.

6. ICAS understands that the estimated tax gap of £1.2bn (by 2022) has been formulated on a similar basis to that in Budget 2016 in respect of the public sector in terms of collected data relating to Companies House registrations, Self-Assessment and corporation tax. ICAS understands the methodology and assumptions undertaken by KAI in the 2016 calculations were approved by the Office for Budget Responsibility and a costing was provided at page 38. It was noted that "the main uncertainties in this costing relate to the size of the tax base and behavioural response".

7. However, ICAS considers that there is a great degree of uncertainty in relation to this tax gap figure, as well as the costing and methodology discussed at paragraph 6 above. This is mainly because of the lack of explanatory evidence to support it in the public domain. In addition, the figures and potential challenges arising from the tax base relating to 2017/18 are as yet unknown due to the time lag in submission of 2017/18 Self-Assessment returns.

8. The main problem for employers whether in the public or private sector is that none of them are experts in employment status, but the IR35 (public sector) regulations and no doubt if they are introduced, the private sector ones as well, place an obligation on employers to suddenly have a comprehensive understanding of an unfamiliar and complicated legal and taxation concept.

9. There is also a major conflict between employment law and employment taxation in terms of the former taking consideration of three statuses (employee, worker and self-employed) whilst tax takes account of two – both of which are further complicated by IR35 legislation and the consideration of a hypothetical contract. Most of this is simply beyond

the knowledge of those individuals left to make a decision in procurement, finance and payroll departments, and is therefore highly likely to be ignored or approached incorrectly in many cases.

10. Some of our members have related to us that there are concerns about public bodies accounting for payroll taxes where none were, in fact, due (ie operating a "blanket" policy. This is neither effective nor helpful as it could result in higher costs for public bodies in delivering its projects as well as potentially causing unwarranted trade and tax tribunal disputes.

11. The Government must recognise that implementation costs are not the only costs which have arisen. Not only has the reporting responsibility shifted from intermediaries to public bodies (and private bodies if these proposed measures are brought in), but also the employer's cost base due to the added secondary Class 1 NICs liability.

12. The Tax Impact Information Note (TIIN) issued by HMRC in March 2017, as well as the previous TIIN of 5 December 2016, highlights this reluctance to acknowledge this issue. They both concentrate, in the main, on the positive impact to the Exchequer and the negligible impact on both one-off and ongoing administration costs for public bodies, but chose to ignore the most important fact of all - tax impact – i.e. that there would be a significant cost impact to those public sector bodies who deem workers providing services through intermediaries liable to IR35 (public sector) and have to put them through the payroll. The statement that "Ongoing costs for accounting and reporting through Real Time Information and using the digital tool are expected to be negligible" is clearly misleading. The costings within the document provide details of the benefit to the Exchequer over time together with the additional benefit of the removal of the 5% expenses allowance, and some admin burden costings. The costings do not, however, set out the estimated secondary Class 1 NICs liability for public bodies.

13. The factsheet accompanying this consultation document also fails to make specific mention of the fact that the reporting and NICs burden has shifted from the intermediary business to the public sector body and actually states: "This consultation is about increasing compliance with the existing rules – not introducing a new tax. Who would be affected by reform to these rules? The off-payroll working rules only affect people working like employees and through a company, and this is not going to change". This statement must be incorrect, because the additional revenues flowing into the Exchequer must represent secondary NICs paid by public authority employers, which is a visible shift in the cost burden from PSCs to employers.

14. Blanket application of the IR35 rules for the public sector in a number of cases has led to an additional cost burden to public sector bodies, which has an impact on public body budgets. In addition, there have been other unintended consequences such as VAT consequences, recruitment and retention impacts on continued service provision, re-negotiation of rates by contractors, cuts to services and headcount reductions in other areas of the business. The lack of transparency on this issue has not been in the best interests of public sector employers. Care needs to be taken to avoid such a scenario in the private sector, which may lead to disputes and increased FTT appeals.

15. The real issue is that the IR35 regime, introduced 18 years ago, has not worked (90% non-compliance) and is unlikely to work as the Government intended. It is complicated, opaque, expensive and as such, a deterrent to widespread compliance.

16. ICAS considers that in relation to both public and private sector regimes, it is not in fact the IR35 legislation which needs to be changed. This is because someone trading through a limited company as a director should be wholly responsible for accounting for any income derived from that business either by way of earned income or dividend income, which are both acceptable ways of extracting remuneration. Taxpayers need certainty and it is not in anyone's best interests to keep changing legislation to make remuneration extraction taxable on a third party unconnected with that PSC other than by way of a business to business relationship.

17. The Companies Act and Insolvency Act should instead be examined and reconfigured to *compliment* the PSC legislation to ensure that the purpose of setting up a limited company or partnership and its activities are consistent with that of a genuine business activity (taking into account risk and other "badges of trade") and going further to prevent liquidations and phoenixism in certain circumstances. The issues around unregulated umbrella companies, managed service companies and accountants "acting" for PSCs should also be reviewed in this context so that appropriate redress can be sought in clear cases of collaborative avoidance. Corporation tax returns could also be changed to incorporate different requirements where there is a "1+1" PSC.

18. In terms of the mutuality of obligation (MOO) point and the CEST tool, ICAS is firmly of the belief that MOO is not relevant to this exercise - but not for the same reasons as HMRC believes it is not relevant because it is already present. MOO does not establish that *any* kind of contract exists. It establishes that there is an irreducible minimum set of obligations for an *employment* contract to exist. As the IR35 legislation is not determining employment status - i.e. whether there is an "employment" or a "self-employment", then this test is rendered null and void. By assuming that MOO is already present, HMRC is negating the need for a CEST decision to be made as it is effectively stating that an employment relationship is already present.

19. What needs to be done if IR35 legislation is to continue to exist and try to function properly, is for the CEST tool to be much more flexible and agile. At present, it is impossible in many cases to provide accurate information (the only basis upon which HMRC will stand by the decision made) because there are two options to choose from – and in many cases, the answer is "none of the above". Thus, the answer being given is "more like A" or "more like B" which is clearly inadequate. Again, additional HMRC resources are required to ensure that the CEST tool is efficient, effective and reliable – otherwise, it is a waste of taxpayers' money.

20. HMRC states that research shows that 60% of results are in favour of the contractor not being in a deemed employment. At present, the CEST tool is capable of being manipulated to obtain the desired response (although ICAS has not obtained any data on how widespread this is - we have simply carried out our own experiments). How can HMRC be certain that there are not more than 40% of contractors who are in deemed employments?

Specific responses to questions

21. We have not responded to all the questions in the consultation.

Q1 What could be done to improve the compliance enquiry process to reduce non-compliance, whilst safeguarding the rights of customers?

22. There needs to be more HMRC resources on the ground. At present, HMRC has been unable to effectively police the existing IR35 regime for the last 18 years. If a new regime is brought in, significant investment in the employer compliance function needs to be brought about.

Q2 Could the public sector regime better fit the needs of businesses? How?

23. The lead-in time for public sector businesses to engage contractors is significantly longer than that in the private sector as there are more decision-making processes required in the public sector. In the private sector, recruitment is much more agile, immediate and decisions are made very rapidly. Any IR35 regime imposed upon the private sector would require a minimum number of steps and be capable of assisting businesses to obtain the flexible engagements they need to remain competitive and provide the right services to customers.

24. The public sector tends, generally speaking, to engage contractors by volume whereas the private sector might recruit by specialism and expertise to carry out a specific task on a short- term basis. The two sectors do not generally work on the same basis and the regimes might need to be different without affecting productivity or the flow of the labour market which would have significant impacts on the economy.

25. In addition, there are some regional differences and devolution also has a part to play. Businesses in London would be likely to operate in a different way to those in North Yorkshire, and the Oil and Gas sector in Aberdeen operates differently to the financial services sector in Edinburgh. Any new tax regime must aim to aid business growth and not provide barriers to business development.

Q3 What if any, changes could help make the administration as simple as possible?

26. It would be better if engagers in the private sector did not become "deemed employers" and did not have to open a payroll to deduct PAYE and NICS from contractor payments. Ideally, some form of CIS style withholding could be imposed instead. In that way, it is the PSC which is suffering the deduction and not the engager. Some businesses will run into serious cash flow difficulties if they are required to deduct and pay over large amounts of PAYE and NICS where this was not required before.

27. IT solutions can be brought in to calculate the withholding and record the details of the PSC so that the PSC has paid an amount on account of the final tax liability for the year. This would achieve three things simultaneously: The PSC makes regular payments on account; HMRC gets a regular inflow of revenue and the engager is not burdened with having to bear additional NICs costs.

Q4 If the private sector rules were changed, do you have any evidence that there are parts of the private sector where the administration of any regime may need to vary even though the basic principles including for determining status, remain the same?

28. Our responses to the other questions cover this point off.

Q5 Is there any evidence that parts of the private sector will not have, or be able to acquire the administrative capacity, knowledge and resources to enable them to implement any changes in relation to off-payroll workers?

29. Due to the fact that the term "private sector" is so widely drawn that it covers any business which is not deemed to be in the public sector and some charities, this means that everything from university spin-out companies, to start-ups, to micro-businesses as well as SMEs and large business are brought in to the scope of any potential new regulations. Each of these businesses will have different capacity to acquire administrative capacity, knowledge and resources. The size of a business does not necessarily determine this however – some businesses are more cash-rich than others even though they are much smaller.

Q6 How could these difficulties be mitigated?

30. Further research on this would need to be undertaken – this is not a question which can be answered in such a generic and simplistic way.

Q7 What aspects of policy design might be adjusted if similar changes were brought in for the private sector? Should we bring in a specific penalty if agencies fail to comply?

31. All aspects of the penalty regime in connection with IR35 in the private sector need to be considered, including the appeals process. This would need to take account of the appropriateness of imposing a penalty at every stage of the process where it could be determined that a failure to comply or failure to report has taken place. The corresponding appeals process within the public sector regime would also need to be reviewed.

32. In a similar way, the appeals process at every stage also needs to be considered as well as the dispute resolution process and tribunal requirements. In addition, the method by which a deemed employer is able to claw back overpaid employer NICs needs to be looked at, where the PSC appeals against the IR35 decision and this is upheld.

Q8 What action should be taken in the case where the fee-payer hasn't acted upon the client's conclusion that the worker would have been regarded as an employee for income tax and NICs purposes if engaged directly? Should an obligation be placed upon the fee-payer to adopt the client's conclusion and there be sanctions for failing to do so?

33. The legislation could easily take account of this process to place an obligation upon those parties in the chain to comply with the regulations. Please see our response to question 7 above.

Q9 What action should be taken if the worker or PSC is knowingly receiving income that has not had the right amount of tax and NICs deducted?

34. Presumably HMRC can incorporate such an eventuality into the legislation to ensure that a suitable remedy is brought about. Culpability would need to be shown to have taken place by one or more than one party to the contract in place. The burden of proof could be with the PSC to demonstrate that they were not aware of the requirements or had due cause to believe that they were paying the correct amounts of income tax and NICs.

Q10 What systems and process changes would businesses need to make?

35. Each individual business would need to decide what was appropriate for them, with some assistance from their professional advisers and IT support as to how best to configure a solution for their individual needs. A 'one size fits all' package would not be suitable. Each business would also need to decide where it would place responsibility for ensuring that IR35 compliance is adhered to. This could be in one department or in several depending on the size and nature of the business.

Q11 Would there be any process and administrative cost implications for businesses. Can you provide evidence of the scale and nature of these?

36. All businesses would need to invest in knowledge, IT/software/storage, professional advice, possibly recruit additional people, and this would be likely to be from the top down as the entire business would be affected. The scale and nature of these cost implications will differ as each business is different. Some businesses will never obtain services from a PSC and others will engage thousands over their lifespan. Again, size is not relevant – it is the nature of the business and its requirements for flexibility of labour which are important features, as well as access to financing.

37. The elephant in the room is of course the substantial cost of employer NICs. Deemed employers will have to pay a tax charge (if NIC is considered to be a tax) on engaging a contractor who does not work for them directly, and to whom they are offering no employment rights.

Q12 Can you provide any evidence that these costs would vary depending on how much notice businesses were provided for the introduction of any reform?

38. No. It is unlikely that the costs would change just because measures were introduced quickly or if they were introduced over a longer timeframe. At a macroeconomic level, it is probably worth waiting for Brexit to settle in so that businesses have time to adjust to this before introducing any new IR35 regime in the private sector. Small and medium businesses may be particularly affected in terms of ongoing business stability and growth.

Q13 Is there anything else HMRC could do to ease the implementation for businesses, and can you provide evidence of how this would ease implementation or administration for businesses?

39. Businesses need simplicity. Training workshops and webinars would help but overall the burden on employers is going to be significant if these measures are brought in. Implementation time needs to be factored in so that businesses have the opportunity to prepare properly. An April 2019 introduction, for example, would simply not allow enough time.

Encouraging or requiring businesses to secure their labour supply chains

Q14 Overall, what are your views on this option? Would it be a proportionate response to the issue?

40. Please see our response at paragraph 30 above. Time is a major consideration for businesses, who generally need to act quickly to obtain skills and talent to enable them to provide a service to customers.

Q15 If the government were to pursue this option, what checks should the client be required to perform?

41. See paragraph 30 above.

Q16 How should different views on employment status be dealt with? For example in the public sector, disputes should be resolved between the client and the worker, which ultimately allows either party to walk away if they do not agree.

42. There is a risk both in the public and private sectors that the engager will find themselves on the wrong end of an employment tribunal claim which can incur significant cost for the engager. It is vital that engagers are given the opportunity and the tools and knowledge to make the right decisions about those they engage, whether through PSCs or otherwise.

Q17 - 24 see our comments above in paragraph 30.

Additional record keeping

Q25 - 31 Overall, what are your views on this option? Would it be a proportionate response to the issue?

43. ICAS does not believe that option 3 is a viable option.

Other options to consider

Q33 Would these, or any of the other options outlined above, be more effective than extending the public sector reform? If so, how would they be more effective and on what grounds would they be preferable to extending the public sector reform?

44. A possible hybrid between options 1 and 2 which included a method for the PSC to indemnify the engager and a flat-rate CIS style deduction could potentially work better for the private sector.