THE ASSOCIATION OF RECRUITMENT CONSULTANCIES

THE ARC COMMENTS ON FINANCE BILL 2017 DRAFT PROVISIONS:

SCHEDULE 1: WORKERS' SERVICES PROVIDED TO PUBLIC SECTOR THROUGH INTERMEDIARIES

About ARC

The Association of Recruitment Consultancies (ARC) is a membership organisation for recruitment businesses. Our members are employers as well as providers of introduction and supply services to other employers and hirers. A large number of our members supply personal service company (PSC) contractors to hirers of which a proportion supply to public sector authorities (PA).

Background

This response follows a roundtable discussion on the draft legislation held by HMRC on 6th January 2017 at which the proposed new HMRC online digital tool was showcased. Some of the practical points raised herein were aired by ourselves and others present. The response is limited to comment on behalf of typical agency providers, and does not address concerns that public sector hirers (referred to in the legislation as 'client' and adopted in this response) may have, although some clients may share the concerns expressed herein. The response also refers to the online digital tool mentioned in guidance but note that it is not referred to in the draft legislation.
We also use personal service companies (PSC) as the example of a contractor vehicle as this is the most common, but of course the IR35 legislation also relates to other kinds of intermediary.
We use the term IR35 to refer to the original intermediaries legislation introduced in 2000.

Executive Summary

(a) The direction of the draft legislation in principle may be unlawful.

(b) The test set out in s.61M (1)(d) is inappropriate.

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(c) The following problems have been identified:

i. liability is unfair and will create unnecessary conflict and information sharing arrangements are insufficient;

ii. there are no transitional measures relating to existing contracts;

iii. the use of a digital tool and lack of provisions relating thereto;

iv. conflicts with existing tax rules under ss.44-47 ITEPA; and

v. other practical aspects.

(d) There will be an undue impact as a result of the complexity which is unnecessary.

(e) We recommend a different and more straightforward approach reversing and simplifying the IR35 test and providing for a payment on account.

Our comments on the draft legislation are as follows.

Legislation potentially unlawful

The underlying principle appears to be that liability for determining status under IR35 should be imposed upon supplying agencies and/or the PA. We are taking further advice on this point and, where there is unlawfulness, we shall be raising this with you in correspondence following this response. We are extremely concerned that the allocation of responsibility in the way proposed amounts to a 'delegation' of HMRC's power, and as such would be unlawful. Although ARC is taking further advice and reserves its rights to present the point differently (or, indeed, to add any further issues of unlawfulness), we feel that it is in the spirit of cooperation and working with HMRC to alert you to the issue now.

Responsibility for determining the application of tax law does not rest with the taxpayer, but with HMRC and ultimately a tax tribunal. Amongst other things there is a clear route set in legislation for a taxpayer to appeal determinations by HMRC. Under this legislation the determination is not made by HMRC, but by the fee paying agency or PA who is then required to use the consequent required payment method. There is no possible path for appeal against a determination of the fee

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payer to a tax tribunal, nor is one contained in this draft legislation or considered in guidance. This would appear to detract from general principles.

For the reasons above, whilst ARC recognises the good intention of HMRC is to address tax avoidance, ARC recommends that the issue of lawfulness of the current proposals should be considered promptly. We also refer you to our recommendations later in this response which if adopted would overcome any potential argument about legality.

The test in s.61M(1)(d) is inappropriate

(i) Whilst the original IR35 legislation uses the test set out in this draft provision, the circumstances in which that test would be applied were entirely different.

(ii) The taxpaying individual or company would always be in possession of facts that enable a decision to be made as to whether IR35 rules may apply, that decision then reflected in the tax return. An agency is unlikely to be in that position.

(iii) An individual may choose to seek advice on the complex test, and rely on that advice in making a tax return. In contrast it will be prohibitively expensive for an agency dealing with multiple assignments to seek advice on each.

(iv) The taxpayer was in control of the deemed employment payment to the individual which was in itself deemed, if IR35 applied, to be made at the end of the tax year. This links with timing of the end of year tax return, and that tax return could then be accepted or investigated by HMRC. The payment under this draft legislation is to be made by the agency with no link to the end of year tax return as it is deemed to be made at the same time as the chain payment, normally weekly or monthly.

(v) Accordingly the test as set out does not work efficiently in these new circumstances and we say is inappropriate. This is largely due to its complexity where

  (a) the likelihood of making an incorrect assessment is high

  (b) the penalty for failing to make an incorrect assessment, namely fines and back payments of PAYE and NICs for failing to make payment of PAYE (where HMRC decides that the rules do apply) is hugely onerous

  (c) the risk affects the value of the agency and its potential long term viability.

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ARC Recommendation - The test should be simplified to provide clarity and to move away from the complex and confusing tests arising from deemed employment status. This in itself would address some of the issues arising from the proposed new online digital tool, which we believe is not and cannot be capable of making a full and proper assessment in all cases.

Also see our further recommendations later in this document which would overcome the issues identified in this section.

Liability and information sharing

(i) In addition to the reasons already expressed above (unlawful; inappropriate test) the imposition of liability on the fee payer is also unfair and will create conflict with the PSC contractor to whom the fee payer is providing a service. The contractor will inevitably wish to be paid gross.

(ii) The decision by the fee payer that s.61N(3) applies and the consequent payment is not dependent upon information either from the client or the PSC. However the fee payer agency is plainly the least likely to be in possession of relevant facts as to application of s.61M(d).

(iii) There is no defence for an agency in the event that it has been provided with incorrect information (as opposed to fraudulent information from the PSC). The PA and/or the PSC should be liable in this event.

(iv) Under s.61S the obligation upon the client to provide a conclusion does not specify the format of that conclusion or address the issue that the conclusion may not be determinate, for example it could state that the PA cannot reach a conclusion – there is no provision for this.

(v) There is no timescale upon the obligation on the client to provide its conclusion save where the agency raises questions. This should be addressed by a short timescale.

(vi) There is no primary obligation upon the client to provide supporting information with its conclusion. Whilst there is an obligation to answer questions, agencies are not legal experts and generally are ill equipped to assess IR35.

(vii) It is not clear that there is any mechanism for the client to follow in making an assessment. Much has been talked on the online digital tool which HMRC has said at the round table

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discussion would amount to 'clearance' which HMRC will stand by, however there is no provision as to how it should be used, when it should be used or by whom it should be used; nor is there any requirement on the client to provide the result from using the tool to any party. As such a conclusion that IR35 applies may well lead to unnecessary conflict with the contractor.

(viii) The client has 31 days from a request to provide its conclusion in respect of a contractor's IR35 status; this can only lead to uncertainly due to the time gap. It is not mandatory that the client provides any information at the outset of the assignment, this leaves the agency unfairly exposed to liability during this period with no recourse to the PA; neither are there any measures that allow for the process to be expedited.

(ix) S61T of the draft legislation includes provision for liability to be transferred to a service provider in the event that fraudulent information is provided. Whilst the potential of liability transfer, in the event of reliance on third party data is welcomed, we strongly criticise the viability of the fraudulent information defence. Establishing fraud is a very high test to meet and suggests that there needs to be some degree of dishonesty. Establishing fraud is particularly difficult where opinion and assessment based upon multiple factors is concerned, as is the case re IR35. An EB should be able to rely confidently upon the information which it is provided by a third party unless it is obviously in error, or it is clearly it is unreasonable to do so.

(x) There is no current proposal within the legislation or guidance to limit the scope of contractual tax indemnities in contractual arrangements between clients and fee payers. Whilst we have noted above that liability is only placed on a client in very limited circumstances, even if this were to occur it is possible that an agency can still be liable as a result of contractual indemnities, which are particularly common within PA terms of business. Accordingly transfer of liability under s.61S(5) will only amount in reality to a cosmetic provision with little practical application.

(xi) The regulation appears to rely on assessment of the rules in advance of an assignment because the requirement upon the fee payer is to make payment as employment income, namely at least every month. In some cases this may be weekly or even daily. It may be impossible to assess the facts ahead of the assignment and it may be impossible to use the online digital tool correctly at that time.

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(xii) Further there are no provisions that allow for reassessment where there is a change in circumstances, for example where there is a change in requirements, role or working practices mid-assignment. For example a substitution in month 3 of an assignment would indicate that the arrangement was outside IR35 in months 1 and 2 yet PAYE and NICs may have been made in months 1 and 2.

(xiii) It is not clear how payments incorrectly made under PAYE and for NICs are to be recovered, or how is this to be addressed in the context of invoices from the PSC?

(xiv) There is no defence allowed for to a claim by a PSC for gross monies due. Accordingly agencies will protect themselves by allowing for provisions in their contracts with the PSC that do not entitle the PSC to gross payment except where the agency determines otherwise. This is likely to result in prejudicing the PSC who may at a later stage be able to establish that IR35 did not apply.

(xv) it is not uncommon in recruitment to have a chain with multiple parties. This is particularly an issue in the public sector where many functions are outsourced, and particularly where RPOs are involved in the contractual chain. A fee payer may be prohibited by contract from discussion with the client and there is no requirement in the legislation upon the RPO. In these scenarios the fee payer may not have the ability to determine contractual terms. The legislation fails to address this key point.

(xvi) Whether an assignment falls inside or outside of IR35 has significant impact on an agency in particular in respect of costs (including 13.8% employers NICs) and contractual arrangements. In addition this may affect liability to pay the apprenticeship levy with risk that recoverable overpayments of NICs would also justify recoverable payments into the levy. Where a rate has been agreed with both the PA and the contractor, a changed status caught by IR35 would have a significant impact on the continuity of the contract and those rates.

(xvii) It is an important principle in the R.12 Conduct of Employment Agencies and Employment Businesses Regulations 2003 (Conduct Regulations) that an employment business (EB) should not withhold payment from a work-seeker on any ground that is within the control of the employment business. The proposed arrangements would require deductions from agreed company gross rate based on a matter in the control of the EB, namely its determination of tax status, and as such would appear to breach this principle.

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ARC Recommendation - It would be better for all parties concerned to be required to agree status at the outset of an assignment (albeit that this assessment could be changed with the agreement of the parties should the factors change). We also propose that, in the absence of agreement to the contrary, IR35 is deemed to apply as the default. R.14 Conduct Regulations requires a contract to be put in place with the work seeker before work finding services are provided. Therefore unless that status is determined early on this regulation cannot be complied with. Please see more on this in the section 'interaction with existing legislation'.

In practical terms the PSC contractor will also need to know at the outset how are they going to be taxed, so that the correct contract can be issued and payment rate be set, and importantly, to enable the contractor to decide whether to take the specific role. This would avoid any detriment and remove conflict.

Also see our further recommendations later in this document which would overcome the issues identified in this section.

Transitional measures

There are currently no transitional measures included within the guidance or draft legislation, specifically in respect of assignments which may be paid for on or after April 6th 2017 but which are taking place now or prior to that date. This presents several issues:

- In the absence of the digital tool, what information should an agency seek and to what extent can they rely on an opinion given by a third party (including a PA)?
- Agencies will inevitably be tied into existing contracts and frameworks, rates and assignments which cannot be altered.

ARC Recommendation - There should be a suitable lead in time, for example 6 months, for the legislation to apply in respect of assignments commencing prior to 6th April 2017, and PAs should be required to amend terms accordingly.

See also our later recommendations which would overcome this issue.

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Digital tool

ARC has numerous issues with the digital tool, including its concept. Our views arise from the showcase we recently attended in January 2017 and from previous round table meetings held with HMRC concerning the development of the tool, where some of the issues we rehearse again here were mentioned.

(i) Focus on substitution.

a. The version of the digital tool the ARC viewed had a significant focus on substitution. Prior to an assignment commencing there can only ever be an *intention* to substitute, as a result the number of questions and focus in this area appears a little excessive. In practice substitution rarely occurs, as to do so will often result in the assignment being terminated.

b. Additionally, recruiters are bound by the Conduct of Employment Agencies and Employment Businesses Regulations 2003, which, along with any contractual requirements, often necessitates the registration of a substitute with the recruiter, thereby precluding a contractor from simply providing someone else.

c. There may also be a genuine and valid reason why a substitute is not acceptable to a client, for example, as the result of a background check.

d. Consequently, the rejection of a substitute may not be a true reflection on IR35 status and the pointers in the digital tool should be careful to acknowledge this reality and Ii was not clear that this is the case.

(ii) The digital tool (in the version viewed) amounts to not much more than an online checklist with a question and answer (yes/no) facility, which records and saves the input and output for future reference.

Whilst it is accepted that there are multiple answers to some questions, and many variables have already been raised, there is no scope for the inclusion, or consideration, of a narrative or explanation. For example, a client may reject a substitute not for personal service requirement reasons, but because the substitute does not have the appropriate security clearance. Equally, services may need to be provided at a client's premises or using its equipment because of software licencing or information security policies. In addition there is no potential for the tool to review the actual contract terms.

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This checklist approach conflicts with well-established general principles of assessing employment status, which emphasise the need to look at the relationship in the round, rather than taking a 'tickbox' approach. See comments by Mummery J in *Hall v Lorimer* (1993) 66 TC 34, and as affirmed in a more recent tax tribunal ruling (*Dhillon & Dhillon v Commissioners for HMRC* TC/2015/03681). In the light of this we contend that the digital tool runs the risk of being heavily criticised by the Courts and its decisions considered not to be in line with leading case law.

(iii) The stated asserting that HMRC will stand by the outcome of the tool but reserves the right to challenge it if information is incorrectly input conflicts with the statement that the outcome will comprise clearance. ARC believes that the two positions entirely conflict and may be contrary to general principles.

(iv) It remains unclear over what period, e.g. where a client inputs correctly at the outset and all parties rely on this assessment, but circumstances change, and the agency still relies upon the given result. Who would be liable in this set of circumstances?

(v) There appears to be no consideration of the impact on the tool in the event of a successful appeal from the output. That impact may be that the tool has to be entirely re-written, and as such any earlier determination made reliant on the tool would be open to challenge.

ARC Recommendation – The tool may be helpful but it should not be promoted by HMRC as definitive. It is understood that this may conflict with the policy around the tool but to promote it in this way would be potentially misleading and as such could potentially be unlawful.

Interaction with existing legislation

(a) The measures do not sit well with the existing agencies tax rules at ss.44-47 ITEPA

If based upon an employment status test an engagement for a public authority client is determined to be outside of IR35, and therefore a gross payment can be made to the PSC. An agency would still have to follow this up with an assessment of whether the agency tax rules as per ss.44-47 ITEPA apply, and therefore have to apply two different sets of tests to the same contractor assignment i.e. an employment status test and whether there is supervision, direction or control (or the right of supervision, direction or control) as to the manner in which the services

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are performed (SDCM). There is an obvious administrative (and therefore costs) burden in making this assessment, plus for SMEs that may not have a dedicated legal or tax function within their organisation, there is potential for confusion and therefore error in these assessments.

(b) There is a potential conflict with requirements under the Conduct of Employment Agencies and Employment Business Regulations 2003

Apart from the requirement for an EB to have terms agreed with a work seeker prior to the provision of work finding services and the withholding payment point already made, it is hard to see how the EB can cover off payment and tax issues contractually since different rates taking into account NICs will clearly have to apply in the different IR35 scenarios. If this arrangement is with a PSC, it is common that it would include a standard provision relating to tax liability and more specifically a clause that remuneration for the services is made by way of employment income (see s.44(3)(b) ITEPA).

(c) Conflict could arise resulting from the finding of employment status under IR35

A contractor, who finds that the hirer or agency determines that IR35 applies, such that the individual is paid under the PAYE rules, is far more likely to make a claim for actual employment status against the hirer and/or for enforcement of worker and/or agency worker rights against the agency or the hirer. The resulting Pandora's Box of litigation could significantly tie up both agency and hirer and the risk of such claims would in itself encourage distrust and lack of confidence in the provision of services by contractors.

It is common for PAs to conclude indemnity provisions in contracts with agencies and so the position forced upon agencies by the legislation could result in an overwhelming burden.

ARC Recommendation –

- A refinement to ss.44-47 to remove the conflict and ambiguity in the context of use of a company contractor.
- As regards the Conduct Regulations there should be some adjustment to those regulations to take into account these factors, if HMRC proceeds as outlined.

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- As regards the potential claims for worker or employment rights there is little HMRC can do if it continues on the current route. However our primary recommendation set out under the heading of Recommendation below would overcome this issue if adopted.

Other Practical issues

The draft legislation introduces a number of practical questions and issues, which as yet remain unanswered, specifically:

- How should the PSCs invoice be addressed (where the arrangement is deemed to be caught by IR35)? Should it still be for the gross amount? If so this will prove complex when the actual payment received is not for the gross amount, as the fee-payer would have had to have made payment of the employment taxes to HMRC;

- The expenses and materials deduction from the PSC invoice where IR35 applies means greater administration for an agency, resulting in additional costs. The general view of our members is that currently not many contractors claim expenses or materials from an agency, so there is potential for increased claims for such costs in light of the proposed draft legislation. It would be preferable were the agency simply to be required to pay the contractor, leaving the contractor to deal with the expenses and materials as part of their self-assessment, in order to ensure that this is properly addressed and the correct amount of tax is paid to HMRC.

Impact

Placing responsibility for IR35 has potential consequences for both agencies and clients. The reality may be that public authority hirers are faced with either additional time and costs in assessing IR35, including using the digital tool, or that they may avoid this by simply deciding to determine that all supplied worker must be treated as PAYE, irrespective of whether IR35 would or would not apply to their assignments. There is already anecdotal evidence of this amongst our members.

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As set out above, due to the limitations on the extent of the 'clearance' available from the digital tool, the reality may be that both public authorities and agencies adopt a cautious approach in any event, and apply PAYE, the likely outcome being either higher rates in order to attract specialist and high level contractors, or of a limited pool of availability, with contactors preferring private sector options where they can with greater scope (i.e. in the basis of their own assessment) to operate outside of IR35. This makes little sense at a time when hard pressed clients not only face a shortage of available talent but are also subject to strict budgetary constraints.

All of these conflicts and problems we set out herein are entirely unnecessary. Despite the hard work done by HMRC to shore up perceived tax avoidance, it has been clear for a long time that the existing IR35 legislation is not working. This we believe is because the core tests are overly complex. The existing IR35 rules require a complex assessment of employment status, relying on the existence of a hypothetical relationship, with enforcement being subject to the resources available to HMRC. Simply applying the same tests but making others in the contractual chain liable is not the correct approach.

Our members reject the proposal for liability as set out in the draft legislation for all the reasons given. Their interest lies in making placements, and they have little or no focus on tax avoidance save at the instance of clients or contractors. That agencies should be liable in these circumstances is inappropriate when alternative more practical options exist.

As we have noted in our responses to previous consultations in this area, there are alternative approaches which we contend would be simpler, reduce ambiguity, achieve increased compliance with the existing IR35 legislation, without being onerous on those parties involved, and which avoid many of the issues outlined above in respect of the draft legislation. We believe that it is particularly important post Brexit that arrangements should be streamlined and efficient, not the opposite, so that the UK can be a better place to do business.

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Recommendations

Contractor supply to the public sector is settled and satisfactory from every perspective save for the matter of tax under IR35. We suggest no change to any rules need be made save for this reason. It appears that HMRC's approach is to deny that anything is wrong with the IR35 rules themselves but instead to continue to rely upon the basic principles set out therein. However as discussed the attempt to massage them to place liability on PAs and agencies is fraught with problems and threatens to disrupt what is otherwise a happy situation. To interfere with basic principles of tax law for reasons that are not wholly clear perhaps could be the position of last resort, but the alternatives do not appear to have been considered. In particular if there are better alternatives HMRC should in all fairness consider them and weigh up the consequences in each case.

In our view and that of our advisers Lawspeed, who have advised in this area since year 2000, the single obvious problem with IR35 is that unless a contractor accepts IR35 applies, HMRC has to prove that IR35 applies, so tying up HMRC with multiple investigations. This has led to the creation of an entire industry supporting contractors wanting to take advantage of company tax rules, and an ongoing and seemingly endless frustrating battle for HMRC. We believe that if the test were reversed, so the default is that IR35 does apply and the contractor has to prove it does not, the position would be massively alleviated.

In addition to that, as HMRC rightly concludes, the hirer or agency is in a position to collect in and make payments to HMRC. Specifically as regards agency supply it is invariably the position that the hirer requires the skill of a particular individual, and large contractor businesses do not use agencies to find work. Therefore there is the possibility for new rules to apply to agency supply that could take advantage of a reverse test. If there were an acceptable definition of a personal service company contractor then similar rules could apply in the case of direct hires by PAs. With that in mind we have formulated a proposal as below.

Finally it appears a driver for the new rules is a desire by HMRC to attach the apprenticeship levy to payments made under IR35 caught arrangements. It is not known how much the value of that levy would be, but the question must be asked whether the measures and disruption are really worth it in the round. ARC objects to the way the levy is being imposed and has submitted a

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separate response and proposal to government officials in relation to that, but we have addressed the levy in the proposal below.

Our proposal

(a) The IR35 test has always been criticised as overly complex. It is ARC's position that this is more so than ever given the increase in the number of company contractors. Its ongoing use as the foundation for a new arrangement can only continue to create dissent and confusion, indeed as we have highlighted herein.

(b) Accordingly we believe there is a strong case for changing the fundamental test in its entirety. Rules relating so mutuality of obligation, direction, supervision and control, personal service each contain ambiguities that lead to tax avoidance. All of these rules should be scrapped. Instead the test could for example be based upon substitution and whether the work is a project, to be defined. We urge HMRC to consider this long term fit for purpose approach rather than proceed down the current flawed and probably damaging path.

(c) In any event we propose that a deduction is made by the agency or PA from the amount due to the PSC, this deduction paid to HMRC on account of the PSC's NICs and PAYE tax liability. The deduction could be set at a suitable level. This approach preserves HMRC cash flow and reflects that taken under the CIS rules although we suggest that here it is simplified to a single on account percentage.

(d) The default should be that IR35 applies (subject to our further point below) with the onus on the contractor to evidence that it does not. This approach reflects that substantially taken in the agency tax rules. However, importantly, it should be noted that many PA clients have been instructed to require their agency workers to be paid on a PAYE or IR35 applicable basis. A default as suggested therefore would simply reflect the reality.

(e) As regards the levy if it is necessary to attach to payments in order to meet HMRC policy, then through regulation any deduction on account as suggested in this proposal could be subject to a levy payment, perhaps deemed to be a payment of secondary national insurance contributions for the purposes only of the levy.

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ARC believes that this proposal if accepted would

- preserve core principles, namely the different tax arrangements of each party, and
- remove risk and administration throughout the supply chain
- avoid the many conflicts and problems that we have set out in this comment document
- be a far simpler, effective and cost effective approach than that set out in the current draft legislation.

We hope our comments are helpful. We would welcome further discussion if desired and commend our proposal to you.

Questions about points made or to arrange any follow up meeting should be addressed to Ben Grover (ben@arc-org.net) or Adrian Marlowe (adrianm@arc-org.net).

The Association of Recruitment Consultancies
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