



22nd March 2017

### **New public sector tax changes and the self employed**

Following the recent decision to scrap an increase in self-employed NICs, I am writing to alert you to another significant tax proposal that will adversely affect UK businesses, increase tax on the self-employed, and attack some fundamental principles. Our members introduce and supply contractors to the public sector.

Schedule 1 to the Finance Bill 2017 (introducing a new Chapter 10 to the Income Tax (Earning and Pensions) Act 2003) proposes changes to existing contractor tax rules, commonly known as IR35, where services are provided to a public sector hirer (PSH). The significant changes are:

- responsibility for assessing and paying tax liability shifts from the contractor to the PSH and/or a supplying recruitment agency (“agency”), significantly increasing the administrative burden on the PSH/agency
- where the tax is assessed to apply, 100% of the contractor’s business invoice for the services is to be deemed to be payment of employment income whereas under existing rules, which continue to apply in the private sector, it attaches to only 95% of a gross payment actually made to the contractor
- the employer NICs liability (approximately 13.8%) will be on top of the business invoice, namely payable by the PSH/agency, with no allowances, whereas under existing rules the employer NICs would be paid by the contractor from the amount the contractor receives after a fixed 5% business expenses allowance
- as a result the amount of PAYE tax and employee NICs will increase proportionately
- VAT is still payable, despite the fact that the payment is deemed employment income to an individual
- a new device that VAT is chargeable on employer NICs paid by the payer, for which the payer has no VAT invoice.

The rules apply when a complex test against employment status is satisfied, which I address further in this letter. However, in short, the contractor is to have responsibility for its own tax assessment taken away from it, employment tax and NICs are to be paid by the invoiced party (not the contractor raising the invoice) on a VATable business invoice for the first time, and both employer NICs and employee PAYE and NICs are to be increased. The device referred to in the final bullet point above is extraordinary and unprecedented to our knowledge.

The additional cost will hit public sector hirers, agencies and contractors hard and the proposal overall will we believe create a series of problems and conflicts that have not been properly thought through, the most important of which I want to highlight to you.

## **Effects and problems**

The most obvious is the impact on rates. A public sector hirer will have to meet a 13.8% employer NICs charge on top of the contractor invoiced rate. In addition, the hirer or agency is likely to have to pay 0.5% Apprenticeship Levy on the invoice amount because of the increase and the artificial imposition of the tax on to the employment payroll, thereby further increasing the financial burden of these changes.

Whilst one way of addressing this is to reduce the headline rate, this of course will result in reduced take home pay for the self-employed individual. However, it also appears that the hirer or agency will be obliged to pay VAT on the difference between the headline rate and the reduced rate on top of the contractor invoiced amount (which will be issued at the reduced rate), the payer having no VAT invoice for that charge. This creates administrative problems, but for public sector hirers that are VAT exempt, it will amount to a direct irrecoverable 20% charge on the value difference.

Where an agency is involved in the supply of a contractor, it will have to meet the additional 13.8% employer NICs. This may equal or exceed the agency's profit charge and so the agency will either have to pass on the additional cost to public sector hirers, or stop supplying contractors to them. In either case this will create real difficulties for the hirer.

As the employment tax charge is on 100% of the contractor's invoice and the contractor only receives a net amount after PAYE and NICs have been deducted for the services of the individual worker, the contractor company will be left with no funds to meet its statutory obligations towards that worker, let alone make any profit.

### **Application of the rules leads to conflict**

The rules apply when a complex series of employment status tests are satisfied, and it is for the public sector hirer or the agency to make the decision which, in the absence of this legislation, would normally be for the contractor and/or HMRC. Because of this, there is a significant risk of practical conflict between the public sector hirer, agency and contractor. Where an agency is involved it will have little knowledge of the relationship between the contractor and hirer, the hirer will want to take the cheapest and least onerous path and the contractor will probably press for gross payment to maximise income. It is likely to lead to an unfair outcome.

The legislation requires the hirer to make a decision before an assignment of the contractor starts, yet case law on the employment tests requires all the circumstances to be considered before and during the assignment. This creates a legal conflict, potentially leading at best to embarrassment for the public sector hirer who is obliged under this legislation to exercise reasonable care, and at worst unlawfulness. Critically, there is no right of appeal against an incorrect decision.

### **HMRC online tool deeply flawed**

HMRC recognises that the employment status tests are complicated and to address this it has created an online assistance tool, and HMRC says it will stand by the outcome from the tool. The consultations make it clear that the tool is central to the success of the policy. However, we have very serious concerns about this approach. Not only are lay people being asked to consider the tests and rule on status such that tax payments follow, but the tool is not yet ready, is in its nth iteration, and its use conflicts with various legal principles. Please see our observations as set out in the Appendix to this letter. Again, its use could lead to unlawfulness in our view.

Suggestions for a different approach put forward during the preceding various consultations have been wholly ignored against the background that the tool is still not complete and the final legislation has only been available for view since 20<sup>th</sup> March 2017, the earlier and first draft dated 5<sup>th</sup> December 2016 having been heavily criticised by industry stakeholders.

### **Immediate Outcome**

On the immediate practical impact, little of which appears to have been considered, there are no transitional provisions. This prejudices those operating under existing contract terms and rates because there is simply no time to renegotiate. Some long term contracts such as HS2 are based on figures that include costs of contracted labour. No time has been allowed for forward planning based on new adjusted rates.

Many contractors have already reportedly decided to shun the public sector in favour of the unaffected private sector. Clearly this and the added costs will have a detrimental effect upon the NHS, schools (both of which are underfunded), government research institutes, all ministries and key large projects (such as HS2), at a time when there are also significant skilled labour shortages. Businesses will be affected as I have described.

### **General principles**

There is one other issue that must be addressed. This new measure is introduced in the name of tax avoidance, yet, as can be seen, it goes far beyond that. It attacks general principles of responsibility for tax status. It is not limited to those situations where an individual would otherwise be an employee were it not for the existence of the company intermediary (for example, a TV presenter for the BBC) as is sometimes cited. Most contractor arrangements are not of that nature, are genuinely temporary and short term. Also, history has proved flexibility to be an asset not a hindrance, but the very concept of flexibility appears under attack.

Under governments of every colour, companies and partnerships have enjoyed different supportive tax regimes in exchange for the business risk they take, the lack of job security, few rights, and the flexibility and growth they provide. Is it acceptable to change this now, in this way? The introduction of conflict between businesses previously working in co-operation, the blurring of lines between business and employment taxes, increased NICs and taxes on enterprise and the self-employed, distortion of market rates and increased bureaucracy appears not only counter intuitive but also seems entirely at odds with Conservative Party manifesto pledges to support business and cut red tape.

The real long term issue is that if allowed to proceed, these changes could set a long lasting and damaging precedent; damaging because it is a move away from supporting business and entrepreneurialism. Whilst for now the proposed changes only apply to the public sector, there is a clear risk that a similar measure may be rolled out to the private sector in due course.

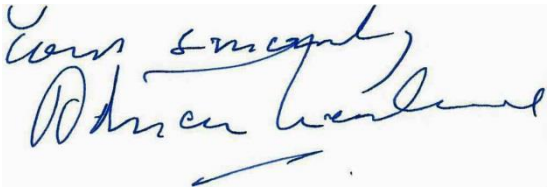
I would add that our members have no interest in promoting tax avoidance and share the view that it should be tackled. We support appropriate measures in principle and in practice and have proposed much simpler alternatives, which can be seen at [www.arc-org.net/IR35options](http://www.arc-org.net/IR35options). The alternatives are simpler because they do not have the negative effects I have described, yet allow HMRC to collect proper levels of tax from contractors.

### **Call to action**

Apart from the question as to why the tax law has to be changed in this onerous way, why does this have to be done now? Brexit looms, and there is already great pressure on our public services.

For the reasons I set out above, we question the need to rush ahead with this proposal. We seek a delay whilst all the issues are fully considered. This issue is not so different from the NICs issue, the outcome of which, before it was scrapped altogether for the duration of this government, was planned to follow the Matthew Taylor report on employment status and corresponding taxation expected in the Summer. Delay, perhaps to the Autumn, will enable all parties to properly engage and resolve a coordinated positive approach.

This legislation will pass into law on 6<sup>th</sup> April unless you take urgent action now. If you agree with our concerns please object to the motion, seek support from your fellow MPs, to whom I have also written, and ask for a delay and a full and proper review.

A handwritten signature in blue ink, appearing to read 'Adrian Marlowe', with a horizontal line underneath.

**Adrian Marlowe**  
Chairman

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## Appendix

### Legal issues with the proposed HMRC online employment status tool

- it uses a checklist approach for assessing employment status and this method has repeatedly been rejected by the law courts
- there is evidence that the results from the tool conflict with decisions made in past authoritative legal cases
- it allows for an 'undecided' outcome, so leaving hirers and agencies confused with no further assistance to hand, and the contractor in limbo
- there is evidence that it passes arrangements that on a proper analysis would fail, so actively permitting tax avoidance
- tax status and the tax that follows is decided by a piece of technology that may not be correctly programmed; if a Court concludes that an outcome of the tool is incorrect the tool will require reprogramming and all decisions based on the tool beforehand may be unsound
- there are no checks, balances or safeguards in place in respect of its programming, which could be changed by HMRC without notice and without proper justification
- there is no provision for appeal of a tool outcome or a decision based on the tool outcome
- whilst HMRC current policy is to say that it will stand by the tool so encouraging reliance upon it, it could at any time and without any process amend that policy leaving exposed those who have relied on it.