

## Response to Consultation “Off Payroll working in the private sector”

### 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. Some supply contractors to hirers in the public sector and a majority provide contractor supply services to hirers in the private sector.

### Introduction

We refer throughout this response to the proposal to address non-compliance by extending the public sector reform to the private sector as “the Proposal”.

We are not in favour of the Proposal, not because there is no issue, but because the Proposal threatens significant disruption without any obvious real need to do so. As will be seen we propose an alternative approach. We have also suggested in our response to the Good Work Consultation (closed June 2018) that the employment status test should in the long term be switched, involving a focus on a business test rather than an employment test, but we do not rehearse those arguments here, given HMRC’s wish to address non-compliance in the shorter term. However the fact that a review of the tests is underway and not yet resolved, the fact that the recruitment sector has faced one tax change after another in recent years leading to a feeling of exhaustion in the industry, and that Brexit itself is creating greater complexity and uncertainty, leads us to advise delay.

We believe the UK should be an attractive place for both local and external businesses to do business in. Even if the tax return claimed is achievable it will come at a price that may detract from our desirability as the preferred place in which to conduct business, and we question the need to take the risk at this particular time.

We are also concerned that the need expressed by HMRC may not be as significant as claimed, simply because little supporting evidence has been disclosed, and there has been no full impact assessment involving the sector as a whole.

## Executive Summary

- There is an issue of non-compliance which needs addressing but the Proposal is over burdensome and unfairly penalises businesses
- The evidence on which HMRC bases the Proposal to address this non-compliance is insufficient to justify the Proposal. The Proposal should not be proceeded with in the absence of a full impact assessment
- The declaration at para 6.29 of the consultation document that other options are out of scope is unnecessarily limiting given the nature of the consultation and the potential impact
- There should be a more targeted and effective approach to non-compliance. The IR35 test should be reversed and payment made on account.
- A review by the Treasury Select Committee should be undertaken
- Imposition of the Proposal in April 2019 is too soon

## Section 1. There is an issue of non-compliance which needs addressing, but the Proposal is over burdensome and unfairly penalises businesses

1.1 The process by which a contractor reports whether the tests apply clearly encourages non-compliance. Not only are the tests themselves inherently difficult for a lay person to comprehend, but lawyers also struggle with them. They allow for a tick box approach and the creation of contracts and arguments that hamper HMRC in its goal of correcting the proper levels of tax. Simply reporting in a tax return whether IR35 tests apply to a particular assignment is obviously open to abuse.

1.2 HMRC's own assessment tool CEST allows for a tick box approach, does not consider the contracts involved, and has been open to significant criticism despite HMRC's best efforts. A full objection to its operation was provided by our lawyers Bindmans in a letter dated 02 March 2017 and the points raised therein remain open.

1.3 It is misguided for HMRC to proceed and extend a scheme which it knows at this stage has not provided a proven acceptable solution. It is one thing to apply it to the public sector, which conduct operations in line with government bidding, and entirely another to extend the same approach to private businesses. Businesses that use contractors range from one man band outfits to multi million pound international organisations which operate on entirely different dynamics from public sector organisations, all with different resources and abilities to understand the Proposal.

1.4 HMRC accepts that there is evidence that decisions on the application of tax are made for reasons other than correct application of a tax test. For example there is plenty of evidence that public sector hirers have made blanket decisions without a proper review of each assignment, despite HMRC's claim that this is only about 10% of cases. Even if this figure is correct this would mean that some 100,000 contractors could be affected unfairly on the face of it if the rules are extended under the Proposal, assuming the contractor headcount is running at 1 million as claimed for the year 2015 (see para 3.1 of the consultation document). HMRC claims that headcount is increasing, so justifying its claim that the tax loss will increase as described in para 1.2.

1.5 Blanket decisions have been made for various reasons

- public sector hirer were apparently encouraged by HMRC to apply the tests across the board in certain sectors, for example education
- the cost of reviewing each assignment properly is prohibitive and time consuming
- the possibility of making a mistake could leave a hirer exposed to tax risk
- supplying agencies have been forced to follow suit for the same reason, exposure to tax risk
- the CEST tool, designed to make decisions easier, is flawed.

1.6 Additional reasons for blanket or incorrect decisions such as relating to cost, efficiency and lack of understanding (particularly for SMEs) are likely to apply in the private sector, where organisations do not have access to government centralised resources.

1.7 The consequence is therefore likely to have been that some contractors have paid inappropriate levels of tax and NICs, and at the same time been prohibited from taking advantage of

tax allowances which they would be entitled to were it not for this scheme. For the reasons given this is likely to multiply exponentially in the private sector.

1.8 What has been dressed up as a simple new arrangement in fact amounts to an inappropriate interference with tax entitlements. This is not to say that HMRC's objective of collecting the correct levels of tax is wrong, but simply that it's method of doing so is misdirected, and it should now properly review that approach.

1.9 For the reasons set out above the time and cost to a hirer or an agency of the Proposal would be burdensome, over bearing and inappropriate.

**Section 2. The evidence on which HMRC bases the Proposal to address this non-compliance is insufficient to justify the change proposed. The Proposal should not be proceeded with in the absence of a full impact assessment**

2.1 At para 1.2 of the consultation document the claim is made that the cost of non-compliance is £700 million. However, this is believed to be merely an estimate and HMRC does not provide any evidence to support it. That there is non-compliance is likely, but a sea change approach to the taxation of businesses based on this claim is not reasonable. That this estimate is used to estimate of loss of £1.2 billion in 2022/3 is also, on the face of it, without basis.

2.2 If the figures are correct it would seem that the figures evidence a serial failure of the original IR35 proposition in Chapter 8 ITEPA and/or an unwillingness on the part of HMRC to enforce legislation which it has always claimed is fit for purpose. This demands a wider and more focused review than that set out in this consultation.

2.3 The claim at para 4.5 of the consultation document that some £400m has been recovered following the public sector reform would imply that the tax recovered was directly comparable with the position prior to the reform in respect of the same taxpayers including the businesses they operate through. However it does not take into account the issues referred to in Section 1 of this response, namely blanket assessments, incorrect CEST results and application of the test incorrectly due to time and cost constraints as well as the inappropriate tax risk.

2.4 For all these reasons the figures referred to in the consultation appear unreliable, and certainly should not be relied upon to justify the Proposal which, if proceeded with, will therefore perpetuate and extend an unfair system.

2.5 Further, no full impact assessment of the entire sector has been produced, which would imply that none has been undertaken despite Rule C of the governments Consultation Principles 2018, which states

## C. Consultations should be informative

Give enough information to ensure that those consulted understand the issues and can give informed responses. Include validated impact assessments of the costs and benefits of the options being considered when possible; this might be required where proposals have an impact on business or the voluntary sector.

### Section 3 The declaration at para 6.29 of the consultation document that other options are out of scope is unnecessarily limiting given the nature of the consultation.

3.1 In ruling various aspects, such as the current status tests, out of scope for the purposes of this consultation, the consultation negates its own purpose. It effectively precludes the need to review flaws in the public sector off payroll rules. However those flaws plainly exist.

3.2 For example the CEST tool has been highly criticised. It claims to be based on the current status tests yet it does not meet those tests in a number of obvious ways

- it cannot review the contracts, required by the tests;
- it purports to reach a result before an assignment commences, yet the tests require an assessment of the facts of the actual assignment during its continuation up to the end of the assignment;
- it assumes mutuality of obligation exists, when the tests require mutuality of obligation to be demonstrated, this often being established from the contracts and live arrangements that exist but CEST does not consider either the contracts or the continuing arrangements;
- it relies upon evidence input by persons who may not actively be involved in the arrangements
- CEST may be an unlawful derogation of the powers of HMRC to a third party

3.3 It is premature to consider use of existing tests within the Proposal, and indeed the Proposal itself is therefore premature

- paras 2.10 to 2.12 of the consultation document acknowledge that the current employment status framework and the tests fall short such that a separate consultation is required.
- the result of that consultation and the government response to it has not yet been published.
- para 2.11 of the consultation document recognises that there may be a need for more certainty and clarity around the tests.

3.4 Despite the above, the current consultation rejects a review of the tests as an option, flying in the face of the evidence that they may be required to change in any event.

3.5 A decision to proceed with the Proposal as currently formulated based on current tests would require costly change to business processes in any event, particularly so if any change to the tests is to be adopted by the government.

3.6 Accordingly the adoption of an option that does not rely on employment status tests to be undertaken either by a hirer or an agency would be appropriate if HMRC is to proceed with any change. It follows that the Proposal based on Chapter 10 as it is, would be inappropriate.

3.7 The Proposal appears to rely on imposing fear of tax liability on companies to effect behavioural change in the use of contractors. This is the result of using tax rules which HMRC knows are uncertain and lack clarity as discussed. Whilst the government may rightly dictate how public sector bodies should operate, this approach should not be appropriate for application to the private sector.

**Section 4 There should be a more targeted and effective approach to non-compliance, in line with HMRC's stated intent to consider all options to address non-compliance. The IR35 test should be reversed and tax paid on account**

4.1 The consultation document at para 5 sets out the challenges that HMRC faces; in dealing with contractors individually, insufficient resources, fragmented supply chains, and time lags and difficulties in the collection of tax. This is against the backdrop that under Chapter 8 contractors are responsible for submitting their own tax returns indicating whether Chapter 8 applies, it being a simple matter for a contractor to indicate that Chapter 8 does not apply.

4.2 To address these issues the Proposal seeks to ensure that hirers and agencies make the decision as to whether the tests apply and if so whether the tests are met, and then apply tax and NICs payments in line with the requirements. The recovery of tax in this way drives a coach and horses through the principle that a business is liable for its own tax. Also as acknowledged by HMRC there is a lack certainty and clarity over the employment status tests.

4.3 The Proposal therefore seeks to circumvent HMRC's problems and challenges by imposing a regime on businesses that should not be liable for another's tax, introducing uncertainty, conflict, risk and lack of clarity (into the relationships) that should not exist. Further these issues may not exist in other jurisdictions, so creating the risk of potentially driving business away from the UK with consequent losses to the Exchequer that have not been factored in. This could be the straw that breaks the camel's back for businesses already worried about Brexit.

4.4 Instead of this HMRC has the option of considering an amendment to the original Chapter 8 legislation which retains the original principles yet which avoids the problems that we have highlighted in this response. The option is to reverse the Chapter 8 rules such that the default position is that Chapter 8 applies and taxes due under it are due unless the contractor can demonstrate otherwise.

4.5 We have proposed this option before and it is not clear why it is rejected. However the most obvious challenges for HMRC would seem to be that it would have to carve out businesses that could be liable to pay Chapter 8 tax ("Subject Contractors"). If that were not an issue the solution must be obvious and compelling. Yet the following applies

- HMRC is in practice seeking to require hirers and agencies to identify Subject Contractors in any event under the Proposal

- HMRC already has requirements for agencies to report gross payments made to contractors supplied by the agencies, which means that Subject Contractors so supplied are already identified under the reporting requirements

4.6 A reversal of the current arrangement under Chapter 8 so far as agencies/intermediaries are concerned would not take up any additional resources in terms of identifying Subject Contractors.

4.7 Each Subject Contractor would then need to establish that the tests do not apply. CEST tool results could be used as sufficient evidence to be submitted with the annual tax return wherever an outside IR35 position is claimed, thus again utilising existing facilities without the need for additional resources.

4.8 The point about time lag for receipt of taxes and collection of tax due is a valid one. There is an existing process for collecting payments on account under the CIS. In all cases of supply of a contractor the agency could account to HMRC for a percentage of the gross payment at a suitable level. This would be deducted from the gross payment made to the contractor. HMRC would then be in receipt of monies up front and could set that as a tax credit against the contractor's correct level of tax and NICs once the tax return is considered. This largely nullifies the problem HMRC has identified.

4.9 HMRC cannot under any circumstances avoid reviewing a company tax return and thus suitable resources must already remain deployed. In imposing risk into the process as suggested in the Proposal the impression is that HMRC prefers to avoid its obligations and outsource them rather than address them directly. The proposal we make herein we suggest restores both HMRC's position and duties whilst retaining responsibility for tax and NIC payments squarely with the contractor. Agencies would have no difficulty in making payments this way, and relationships would not be affected.

4.10 ARC's proposal addresses the position where agencies are involved and it is noted that hirers do not have the same reporting requirements. It would be easier and more effective for hirers to have a reporting requirement wherever it makes a gross payment to a company, and HMRC could set rules around that, setting out criteria for identifying a Subject Contractor. The rules must be based on the tests that HMRC suggests in the Proposal would be deployed in any event, but would be much easier for hirers to follow and deploy than the changes required under the Proposal.

4.11 The result of our proposition

- would not interfere with the flexibility of the current workforce
- would be easier to deploy
- would avoid the confusion, complexity and lack of clarity that followed Chapter 10
- requires no new test or certification
- would require minimum software changes
- would take risk out of the equation
- would not interfere with traditional relationships
- would not make the UK a more difficult place to do business in.

4.12 It is not clear why under para 6.36 and 6.37 of the consultation document that a withholding arrangement is rejected. Perhaps the proposal already considered and rejected as referred to in

those paragraphs is different from our proposal herein. Under ARC's proposal there would be no need for new certifications or tests, which may have been a consideration in the rejection of a withholding arrangement.

### Section 5 A review by the Treasury Select Committee should be undertaken

5.1 We wrote to all MPs prior to inclusion of Chapter 10 within the Finance Bill 2017, and the evidence we produced was set to be considered by the Treasury Select Committee. However the proposed hearing did not proceed due to the announcement of the last general election.

5.2 There has been no proper independent review of Chapter 10 by the Treasury select Committee. A review of the Proposal in the light of contemporary evidence should now be undertaken on the basis that

- the rules are overly onerous on business – they may apply to public sector which the government can control, but application to the private sector is inappropriate
- as Matthew Taylor indicated the flexible workforce is a key asset of the UK, yet the Proposal threatens to interfere with that flexibility
- the Proposal attempts to hijack normal tax rules relevant to businesses in the absence of any Parliamentary direction in that regard
- the government has not yet decided upon direction following the Matthew Taylor review
- the uncertainty caused by Brexit will be exacerbated by a change to the rules which will make doing business in the UK less attractive.

### Imposition of the Proposal in April 2019 is too soon

6.1 Most businesses particularly large ones operate on 3 year budgets. Businesses also largely rely on software to control and accurately identify tax and NICs liabilities. The imposition of the Proposal in April 2019 will not allow sufficient time for budget changes to be made, software to be developed or staff to be trained.

6.2 For all the reasons set out in this response sufficient time should be allowed to consider suitable alternative ideas that meet HMRC's objective whilst looking at the wider picture in the round.

## Conclusion

We recognise that change needs to be made. However the Proposal is overly onerous and most private businesses will not be able to understand or correctly apply the requirements. Further the use of fear and risk as a tool to drive behavioural use of companies is inappropriate. Our alternative proposal as set out in section 4 we suggest would require minimum change or interference and would allow the use of existing HMRC's resources whilst at the same time providing the Treasury with a significant recover of tax and NICs. We commend this to you.

A number of questions have been raised in the consultation document, and we trust this response provides the answers.

Questions about points made or to arrange any follow up meeting should be addressed to ARC Chairman Adrian Marlowe ([adrianm@arc-org.net](mailto:adrianm@arc-org.net)).

**The Association of Recruitment Consultancies**

**9th August 2018**

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