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 and Executive Summary

We refer to the proposal contained in the Consultation document throughout as ‘the Proposal’. We also use the term ‘Hirer’ instead of ‘Client’ as Hirer more accurately defines the party who has the benefit of the work and it avoids misinterpretation, for example in a chain supply arrangement an RPO may be referred to by the supplying agency as ‘the Client’ yet the RPO would not be the party responsible for making the IR35 decision.

We support the principle of addressing tax avoidance which we believe has long been required. However we have strong reservations concerning the proposals as outlined in the consultation document for the reasons set out herein. The headline points are:

- Timing of the Proposal is wrong.
- Aspects of the Proposal contravene established principles for the introduction of new law. CEST remains a work in progress and is not fit for purpose. The Proposal departs from principles in Chapter 8 and amounts to a new tax.
- The Proposal conflicts with existing statutory (Chapter 8) and case law.
- The declaration at page 5 of the consultation document that the consultation is not intended to consider alternative approaches to non-compliance is unnecessarily limiting given the nature of the consultation and its potential impact.
- The Proposal may at worst affect the commercial viability of a large number of organisations, and at best contains ideas which will cause real commercial difficulty to private sector organisations, including our members and their clients. Either way the consequence will include a wide ranging impact on reporting and governance requirements.
- The requirement for payment to be part of payroll, so collecting more employer NICs and apprenticeship levy, should be made obvious and transparent, subject to suitable TSC and judicial scrutiny.
- The use of fear and risk of tax claims as a tool to drive business behaviour is inappropriate, given the apparent intended consequence that will inevitably prejudice use of contractors.
- Tribunal claims will result at considerable expense to the tax payer.
For all the reasons summarised above we believe the Proposal is over burdensome and unfair. We have suggested some efficiencies in this response which would go some way to addressing administrative burdens.

We commend this to you.

**Timing**

There has been insufficient time to evaluate the real impact of operations in the public sector, with few challenges that could relate to the private sector to evidence that the same methodology could work well. Indeed the Proposal sets out some new ideas which clearly mean that Chapter 10 contains flaws, and note that the Proposal seeks to address some of the problems.

Further the public sector rules were set to be reviewed by the Treasury Select Committee (TSC) before their introduction, but the scheduled hearing for that review was cancelled due to an announcement of the last general election. Therefore, there has been no TSC review and this ought to take place before the Proposal is regarded as suitable.

There has been no full impact assessment.

**Established principles**

It has long been established that law should be clear and ascertainable. The Proposal does not meet this requirement in two fundamental respects.

**CEST**

Whilst it is not mandatory for anyone to use the CEST tool, it nevertheless is provided under HMRC’s name and with that the implication that it must and should be correct. For all the reasons rehearsed in previous consultation responses and in correspondence between Bindmans (lawyers acting on our behalf) and HMRC, it is our opinion the CEST tool remains significantly unfit for purpose and is misleading. In our view, it is logically unable to ever achieve a definitive reliable assessment of status in the circumstances for which it has been devised, namely the assessment of ‘grey area’ engagements where it is not obvious that the rules apply one way or another. We do not comment further on CEST in this response and simply repeat our previous observations that use of the tool will provide inaccurate results leading to inappropriate decisions and incorrect levels of tax being paid in some cases.

Since CEST was introduced to assist assessments under Chapter 10 and is proposed to be used for new assessments following this Proposal, for the reasons given above reliance upon in any respect breaches the principle of ‘legality’.

**New Tax**

The statement made in the second paragraph of the consultation document’s introduction states that the reform does not introduce a new tax, yet the political and administrative implications provide evidence to the contrary.

By not treating the tax as new, is transparency being lost? We believe that there should be more transparency in the Proposal and the rules should be assessed using an entirely different vehicle. It
appears that the Proposal is being dressed as an adjustment to the 2000 rules using a similar concept of employment status. Rather, it actually imposes a new tax on businesses, as now detailed, which should be considered in an entirely different manner. Further from a political perspective it appears to contravene promises made in the Conservative Party Manifesto at the last general election.

Firstly, the 5% top slice expenses allowance for contractors and arrangements to which the old IR35 rules apply is to be taxed also. This proposal is not a simple scrapping of the allowance by adjusting existing tax rules, but presents itself as a new charge on the 5% top slice as private sector contractors working for small businesses are to retain the 5% allowance.

Second, the imposition of payment of employer NICs on the ‘fee-payer’, being the new deemed employer liable to account for the payments, did not previously exist under Chapter 8. Currently, employment status is assessed by the individual providing services, yet the new rules propose that this assessment is to be made by the Hirer. The Proposal suggests that such assessment ought to be made and passed before work commences. This contravenes the premise of Chapter 8 which requires the arrangement to be assessed in its totality, allowing time for the gathering of evidence to establish the nature of the contractual relationship. Contrary to case law and precedent, the new rules pose a significant conflict and fundamental change to the assessment process, as opposed to merely massaging Chapter 8’s provisions.

Thirdly, the amount of employer NICs, employee NICs and PAYE will now be calculated on the gross sum of the contractor’s invoice for work charged. This is also new as PAYE and NICs due from a contractor’s company under Chapter 8 would be calculated on the net sums, always less than the full invoice sum, even if you don’t take into account the 5% top slice allowance. The result is a significant uplift of PAYE and NICs to be received by HMRC from the liable party over and above the amounts that HMRC could have expected under Chapter 8 from the contractor.

For the reasons given above the Proposal is misleading and the introduction of law on this basis would appear to contravene the principle of ‘legality’.

**Commercial Consequence**

There are consequent significant commercial ramifications. Under the Proposal, whichever decision a Hirer makes as to IR35 status, the potential liability that follows may have to be reflected in the accounts of the Hirer and every business involved in the supply chain. Each will face a contingent liability under the Proposal as it stands, which many will want to avoid.

The contingency is the prospect of a tax investigation and requirement to meet underpayments of PAYE and NICs for up to 6 years, possibly longer given the time it takes to conclude an investigation. It arises wherever the IR35 determination is that the arrangement is outside the rules, as this is the obvious trigger for an HMRC investigation, but also arises where the fee-payer fails to account to HMRC for correct PAYE and NICs, leading to a tax investigation. The requirement that a business in the chain above the fee-payer is liable when the arrangement is deemed non-compliant, ultimately impacts all in the contractual chain when HMRC are unable to recover amounts from the fee-payer, so seeks payment from the next in line.
A further difficulty arises from the rules that the Hirer becomes the fee-payer if it did not take reasonable care in making the status assessment, or it failed to make an assessment and notify as required. Smaller hirers may be ignorant of the rules, but in addition it would be easy for time limits to slip so making the Hirer liable as the fee-payer. A tax investigation many years after an assignment of a contractor may identify that a Hirer who is liable as the fee-payer has not accounted for tax and NICs.

Liabilities as described which are correctly reflected in the accounts of a business may affect capital values. Liabilities as described which are not reflected in the accounts may give rise to litigation, so affecting capital values and operational viability. Liabilities of which the Hirer is unaware may give rise to HMRC claims for significant payments, so affecting the future viability of the business concerned. The Proposal does not contain any provision for acceptance by HMRC of any assessment at any time.
Consultation Questions

Q1: Do you agree with taking a simplified approach for bringing non-corporate entities into the scope of the reform? If not, are there alternative tests for non-corporates that the government should consider? Could either of the two simplified approaches bring entities into scope, which should otherwise be excluded from the reform? Is it likely to apply consistently to the full range of entities and structures operating in the private sector?

In defining the scope of the reform, the Proposal suggests that small businesses should be exempt. It recommends the test deeming a company ‘small’ if it meets two of the three criteria:

- Annual Turnover – <£10.2m
- Balance Sheet Total – <£5.1m
- Number of Employees – <50

We believe that there should be a simplified approach. In our view, the only preferable option is determining how many employees a company has, as the other two criteria would need to be answered by a Finance Director or director, someone other than the person recruiting. In a recruitment scenario, it would be difficult for a recruitment business to ask a Hirer about its profit, turnover and balance sheet. Furthermore, there would be no way to determine if a Hirer’s representative were privy to the correct answers. Additionally, such answers may involve the disclosure of information sensitive to the company concerned.

It is our view that the same test should apply to both corporates and non-corporates, namely solely on the basis of the number of employees.

Identifying the status of a Hirer as regards value and number of employees requires information exchange. Since the information comes from the Hirer, if it transpires to be incorrect, the party liable should be the Hirer and not any other person relying upon the information.

Further, we recommend that the information to be sought should be required to be recorded in a specific format to avoid confusion.

Q2: Would a requirement for clients to provide a status determination directly to workers they engage, as well as the party they contract with, give off-payroll workers sufficient certainty over their tax position and their obligations under the off-payroll reform?

As with the public authority rules, the Proposal requires the Hirer to assess and decide if the IR35 rules do or do not apply and pass that decision to the contractor, or, if there is a chain, to the party it is dealing with. That party in turn must pass the decision down the chain.

There should be a default, to avoid unnecessary admin

The Proposal to pass down a decision that the rules apply makes no sense and introduces an entirely unnecessary wave of administration. We recommend that the need to pass down information should only apply if the Hirer decides the rules do not apply. If this were adopted, the default position would be that the rules do apply, thus there is no need for an evaluation or communication, not a need for any of the information requirements. The fee-payer would have to apply the consequent tax requirement unless it has been told the rules do not apply. In situations where the
client does not provide the determination, the new rules create a tax burden that circulates between all parties.

In many cases, it will be obvious that the job requires some level of supervision, direction, or control. The reduced administration arising from our suggested approach will mean that from the outset the position is crystal clear to all parties. Further, it avoids the conflicts that arise from the requirement to make an assessment before the work begins, as the case law and Chapter 8 requirement that all contracts and working practices must be considered in reaching a decision.

Hirers will choose to avoid the rules simply because of the penalties that could arise, and as such will refrain from using a contractor operating through an intermediary. Instead, they will only make an assessment where the contractor is strictly necessary for a defined piece of work and there is likely to be no deemed employment status.

There should be no requirement to provide a decision to any other party unless a decision is that the rules do not apply. In the event that HMRC does not consider our proposition acceptable, we consider that the suggestion for a Hirer to inform a contractor directly where there is a chain supply, is impractical and unnecessarily interferes with the tripartite contractual arrangements that normally exist.

The only potential justification for this requirement seems to be so to satisfy the contractor, yet the only reason as to why the new rules are proposed is because of alleged serial contractor non-compliance. This proposed requirement creates exponential administration, as in many cases the Hirer is unlikely to know who the contractor is at the time of determination.

**Timing of a decision is confusing**

The requirement to pass down information gives rise to an issue regarding the timing of the decision. As drafted, chapter 10 requires an assessment of the status of “the worker” rather than the services to be performed, which by nature therefore requires an assessment once contractual arrangements have been agreed. This arrangement does not reflect the commercial reality of the transactions concerned, decisions will need to be made at an earlier stage in order that commercial arrangements can be set.

Further Chapter 8 requires there to be an assessment of the arrangement, not the worker.

The idea that a decision can be changed at any time is also confusing. Commercially a contract will set the basis of the arrangement between the parties. It is offensive to basic commercial and contract law that rates can be altered by one party without the consent of the other. The idea also interferes with the requirement to decide on status before the work starts and provides inequality in bargaining power, requiring as it would do the fee-payer to change rates and accept the Employer NICs burden without any opportunity to reassess viability of the relationships with both the Hirer and the contractor.

**Q3: Would a requirement in parties in the labour supply chain to pass on the client’s determination (and reasons where provided) until it reaches the fee-payer, give the fee-payer sufficient certainty over its tax position and its obligations under the off-payroll reform?**
Reasons provided for Question 2 also apply in respect of this question. The Proposal would not provide sufficient certainty given the proposition that the Hirer can change its status decision at any time. This is not currently in Chapter 10. In reality where status changes there would need to be a new contract between the relevant parties, which some parties may not be willing to accept. Not only does this introduce further administration, but a changed decision may have a retrospective effect on payments already made. Unscrupulous Hirers may in the Hirer contract prohibit termination of an assignment where the Hirer decides late that the rules apply, imposing an effective penalty equivalent to the Employer NICs on the fee-payer, eroding if not negating any potential profit of the fee-payer. The unfairness of the proposition is palpable.

Uncertainty also arises where the Hirer has failed to pass down information, by not making a decision before works starts. Chapter 10 states that in those circumstances the Hirer becomes the fee-payer. How does this sit with the Proposal that the Hirer can correct its position by making a late determination whenever a payment is made (see page 10 of the Proposal)?

It is not clear what is meant by the proposition that change (of decision on status) can be made at the time payment is made. Invoices may be delivered and/or payment may be made months after the work was provided. This in our view does not work. Further a change of decision may have some kind of retrospective effect, where for example the Hirer changes its view but the work has never changed, so indicating incorrect tax application from the outset of the assignment. This is highly confusing and could lead to both contract terms and tax non compliance.

Q4: What circumstances might result in a breakdown in the information being cascaded to the fee-payer? What circumstances may result in a party in the contractual chain making a payment for the off-payroll worker’s services but prevent them from passing on a status determination?

The circumstances that may result in a breakdown will simply be due to administrative failure and unnecessary contractual breaches inherent in HMRC’s proposition.

Q5: What circumstances would benefit from a simplified information flow? Are there commercial reasons why a labour supply chain would have more than two entities between the workers’ PSC and the client? Does the contract between the fee-payer and the client present any issues for those or other parties in the labour supply chain?

The only circumstances that would simplify the arrangement would be if the default position was that the rules apply and the decision does not need to be passed down. Only when the rules do not apply should this decision be passed on. Otherwise see our answer to Q8.

Q6: How might the client be able to easily identify the fee-payer? Would that approach impose a significant burden on the client? If so, how might this burden be mitigated?

Again, if the default position were that a decision should be passed only when the rules do not apply would the fee-payer be easily identifiable and any burden mitigated.

Q7: Are there any potential unintended consequences or impacts of placing a requirement for the worker’s PSC to consider whether Chapter 8, Part 2 ITEPA 2003 should be applied to an
engagement where they have not received a determination from a public sector or medium/large-sized client organisation taking such an approach?

It is our position that this question is nonsensical. The Proposal claims that Chapter 8 will continue to apply where the Hirer is a small company, but there is no requirement under Chapter 8 for anyone other than the PSC to make the decision. It is our understanding of Question 7 that Chapter 10 will always apply to the public sector organisations with no exemptions.

Q8: On average, how many parties are there in a typical labour supply chain that you use or are a part of? What role do each of the parties in the chain fulfil? In which sectors do you typically operate? Are there specific types of roles or industries that you would typically require off-payroll workers for? If so, what are they?

The number of parties in a contractual supply chain can vary enormously and are sometimes comprised of multiple contractual arrangements. Where the Hirer uses a Master Vendor or RPO it is common for the contractual arrangements to include a prohibition on a party lower in the chain from contacting the Hirer.

The Proposal states the fee-payer should be liable where the client decides that the IR35 rules do not apply, imposing a wholly unfair burden on the fee-payer. We advocate that liability should rest entirely with the Hirer who makes the decision to avoid a manifestly burdensome and disproportionate result. Furthermore, the Proposal imposes contingent liability on all contractual parties, potentially requiring liability to be demonstrated on company accounts, thus operating as a deterrent to the engagement of contractors who fall outside IR35’s scope.

Q9: We expect that agencies at the top of the supply chain will assure the compliance of other parties, further down the labour supply chain, if they are ultimately liable for the tax loss to HMRC that arises as a result of non-compliance. Does this approach achieve that result?

Investigations arising from the non-compliant behaviour of a party lower in the supply chain introduce cost and administration let alone the risk of tax and NICs due. Indemnity clauses cannot avoid the admin burden. The proposition would interfere with relationships and trust between parties.

The approach taken is therefore disproportionate, burdensome, and achieves nothing other than HMRC’s satisfaction that it would have multiple targets for tax collection, contrary to all basic principles of legality. It is simply wrong that absolute liability should be imposed in the way suggested.

One further issue arises over the assessment of employment status. Chapter 10 makes it clear that the Hirer becomes the fee-payer if it does not take reasonable care over the decision. This is a defence only for another party that would be the fee-payer, to transfer liability for unpaid taxes and NICs to the Hirer. It does not mean that the Hirer must take reasonable care in all cases as a positive obligation. Since the reasonable care argument will only ever arise in the context of a tax investigation, there should be clarity surrounding this; noting that an investigation will only ever occur where HMRC does not receive the correct PAYE and NICs. In turn, this means that the correct identity of the fee-payer may only be known some considerable time after the assignment.
Our recommendation is that the Hirer should be the only party liable for unpaid levels of tax and NICs where the Hirer has decided that the rules do not apply, but HMRC considers and proves otherwise.

Finally, on the point of this assessment, there are strong indications that agencies are being encouraged to make their own assessments by outsourcing to third parties. This can only mean agencies are being pushed to decide that the rules do not apply when a Hirer has decided otherwise. There is some evidence that third parties are offering to cover the assessment with insurance. In our opinion, this approach can only lead to further tax avoidance and could damage the reputation of the recruitment supply industry.

Q10: Are there any unintended consequences or impact of collecting the tax and NICs liability from the first agency in the chain in this way?

Q11: Would liability for any unpaid income tax and NICs due falling to the engager (if it could not be recovered from the first agency in the chain), encourage clients to take steps to assure the compliance of other parties in the supply chain?

Q12: Are there any potential unintended consequences or impact of taking such an approach?

For Questions 10, 11 and 12 the same answer as Question 9 applies.

We question what consequences HMRC envisaged as the outcome of this proposal. It seems that the intended consequence is to deter the use of contractors. On the face of the proposition, HMRC must have considered the commercial consequence of the Proposal and all its facets, recognising the deterrent factor in imposing potential liability on the supply chain. As such, the consequence of that deterrent appears to be intended by HMRC and cannot be regarded as an unintended consequence. However for the record the consequence of the Proposal will be to deter the use of contractors operating through qualifying intermediaries and drive business directly to the use of alternative models, such as umbrella companies, and/or new tax avoidance vehicles or operators purporting to provide solutions.

Interference with flexibility would therefore be the result. If HMRC were to rely on and perhaps change Chapter 8 to deal with enforcement better, this entire Proposal with all its negative consequences, could be avoided. The idea that a new law is required simply because payment should be part of payroll, so collecting more employer NICs and apprenticeship levy, should be avoided, or in line with the principle of legality, be made obvious and transparent, subject to suitable TSC and judicial scrutiny.

Q13: Would a requirement for clients to provide the reasons for their status determination directly to the off-payroll worker and/or the fee-payer on request where those reasons do not form part of their determination impose a significant burden on the client? If so, how might this burden be mitigated?

Requiring a client to justify their status determination is significantly burdensome. It is commercially counter-intuitive for a Hirer to provide such reasoning and is unlikely they will want to comply. As
such, it appears to be an intended consequence of the Proposition to deter a Hirer from engaging contractors completely.

**Q14: Is it desirable for a client-led process for resolving status disagreements to be put in place to allow off-payroll workers and fee-payers to challenge status determinations?**

Again, it is commercially counter-intuitive for a Hirer to establish an appeal process for resolving status disagreements. This proposition reinforces the notion that Hirers are being deterred from engaging contractors.

**Q15: Would setting up and administering such a process impose significant burdens on clients?**

Yes, the availability of such a process would place administrative burdens on a client. Such a process has the ability to create conflict with a temporary worker and interfere with the working relationship. In most circumstances the client has no need for a specific individual to undertake the work.

**Q16: Does the requirement on the client to provide the off-payroll worker with the determination, giving the off-payroll worker and fee-payer the right to request the reasons for that determination and to review that determination in light of any representations made by the off-payroll worker of the fee-payer, go far enough to incentivise clients to take reasonable care when making a status determination?**

It seems the Proposal goes much too far. We do not understand the question. There is no current proposition that the client should take reasonable care when making a decision. The only proposal present is that reasonable care should only be relevant to identifying the fee-payer in circumstances where HMRC may decide that the rules apply where a Hirer has determined they do not. The only incentive for clients to make appropriate decisions should relate to those decisions where the rules do not apply, as such permitting the fee-payer to pay the contractor on a normal gross basis. The Hirer should be liable for its decision in these circumstances only.

**Q17: How likely is an off-payroll worker to make pension contributions through their fee-payer in this way? How likely is a fee-payer to offer an option to make pension contributions in this way? What administrative burdens might fee-payers face which would reduce the likelihood of them making contributions to the off-payroll worker’s pensions?**

In the context of a contractual supply arrangement, it is our opinion that the fee-payer is unlikely to want to add any administrative burden such as setting up pension contributions.

**Q18: Are there any other issues that you believe the government needs to consider when implementing the reform?**

The additional issues the government ought to consider are set out in this response. We suggest that liability ought to rest with the Hirer for when their decision is that the new IR35 rules do not apply. There has been no proposition in the consultation paper for a suitable outcome avoiding all the consequences we have referred to.
Referring to contractors as ‘off-payroll workers’ conflicts with the commercial and tax position of such individuals who would, if the rules apply, be ‘on payroll’. Use of the word ‘worker’ is also confusing.

Finally, although the Proposal excludes consideration of the relationship between employment status and IR35 status, it is obvious that the deeming of a person as an on payroll worker will induce Tribunal claims for worker and employment rights at the expense of those involved and the tax payer.

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

The Association of Recruitment Consultancies

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