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Personal service companies & IR35

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Summary

‘IR35’ is the commonly-used term for legislation introduced in 2000 to tackle the misuse of personal service companies (PSCs) for tax avoidance purposes.

The term ‘personal service company’ (PSC) is not defined in law, but is usually taken to mean a limited company, the sole or main shareholder of which is also its director, who, instead of working directly for clients, or taking up employment with other businesses, operates through their own company. For any engagement the client will pay the PSC for the individual’s services without first deducting income tax or employee National Insurance contributions (NICs) as it would for any employee under PAYE.

There are several possible tax advantages to this type of arrangement for the individual, further to the wider potential benefits from freelancing. First, the range of expenses which the PSC may set against its taxable profits will be much wider than that allowed an employee to set against their taxable income. Second, there will be a cash-flow benefit in avoiding tax being deducted at source each month. Third, the individual may be in a position to be paid dividends by their PSC, as an alternative to only being paid earnings as the PSC’s employee, and this form of income would not be subject to NICs.

There are also potential financial benefits for the client organisation to this arrangement: they do not incur employer NICs on the payment they make to the PSC, and do not have to provide various rights and entitlements that employees enjoy (such as holiday pay, sick pay and working time protections).1

By the late 1990s there were concerns that PSCs were being widely used to disguise the fact that in many situations individuals were working effectively as their client’s employee, while garnering these tax benefits. To counter this type of tax avoidance in the March 1999 Budget the Labour Government announced it would introduce provisions to allow the tax authorities to look through a contractual relationship, where services provided through an intermediary such as a PSC, but the underlying relationship between the worker and the client had the characteristics of employment. In those circumstances, the engagement would be treated as employment for tax purposes. Initially it was proposed that it would be the responsibility of the client organisation to determine if any engagement met this test.

The proposals proved highly contentious. Many businesses raised concerns as to the potential administrative burden in having to assess each and every contract, as there is no simple statutory test to determining employment status for tax purposes.2

After consultation the Labour Government announced a new approach. Intermediaries would be required to assess whether:

- where a worker provided services under a contract between a client and an intermediary; and,
- but for the presence of the intermediary, the income arising would have been treated as coming from an office or employment held by the worker under the existing rules used to determine the boundary between employment and self-

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1 These are characterised as the ‘push’ and ‘pull’ factors driving the growth of PSCs (House of Lords Select Committee on PSCs, Personal service companies, HL Paper 160, 7 April 2014 para 22-38).

2 As the Office for Tax Simplification has noted, “employment status is established ultimately by case law but, on an everyday basis, it is up to the business or individual to figure out whether they are employed or self-employed.” (OTS, Employment status report, March 2015 para 2.1).
employment income for tax purposes, if the individual had contracted directly with the client.

If so, the intermediary would be required to account for tax on this payment in just the same way as employee earnings (i.e., charge income tax under PAYE and Class 1 NICs).

Provision to this effect was included in the Finance Act 2000 with effect from the 2000/01 tax year. The legislation is commonly called ‘IR35’, after the number of the Budget press notice which first announced this measure.

For the last 20 years IR35 has remained controversial, and many have argued for its abolition. However, although its operation has been reviewed more than once, governments have considered this would pose too great a risk to the Exchequer.

Over the next decade IR35 remained controversial in the freelance community, although the Labour Government consistently opposed calls for it to be scrapped.

In July 2010 the Coalition Government announced the newly-established the Office of Tax Simplification (OTS) would review small business taxation, and this would include exploring “alternative legislative approaches to IR35.” The OTS completed its report just before the 2011 Budget. It set out several options for reform, including a merger of income tax and NICs which would make IR35 obsolete. In the absence of major structural change the OTS suggested that IR35 might be suspended with a view to being abolished, or amended to exempt certain businesses, or retained but with certain changes in its application. In the 2011 Budget the Government announced that IR35 would be retained “as abolition would put substantial revenue at risk,” though its administration would be improved.

In its first Budget following the 2015 General Election, the Conservative Government confirmed it would “engage with stakeholders this year on how to improve the effectiveness of existing intermediaries legislation.” A discussion document was published later that month; responses were invited by the end of September 2015. On the matter of compliance, the paper noted, “in 2011/12 around 10,000 people paid tax under IR35, an estimated 10% of those who should have paid tax on at least part of the income their PSC receives under the legislation.”

One question raised in this document was whether the onus for determining whether IR35 applied or not should be placed on the client, rather than the PSC: “under such an arrangement, those who engage a worker through a PSC would need to consider whether or not IR35 applies (in the same way as they would need to consider whether a worker should be self-employed or actually be an employee), and, if so, deduct the correct amounts of income tax and NICs as they would for direct employees.” The paper also asked for views on whether the tests to determine if IR35 applies could be simplified.

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3  HMRC publish guidance on the IR35 rules on Gov.uk.
4  Inland Revenue Budget press notice IR35, Countering avoidance in the provision of personal services, 9 March 1999
5  HM Treasury press notice 29/10 20 July 2010
7  Budget 2011, HC 936 March 2011 para 2.203.
8  Budget 2015, HC 264, July 2015 para 2.183
9  Intermediaries Legislation (IR35): discussion document, 17 July 2015 p4
“such as requiring an engagement to last a certain minimum amount of time to be considered one of employment.”

In November 2015 there were reports that the Government was planning a change in these rules so that any contractor whose placement lasted more than a month would have to go onto the client’s payroll as their employee. However, despite expectations, the Government did not announce major reforms to the rules at this time.

Over this period there have also been concerns about the use of PSCs by senior staff in the public sector, and by contractors working for the BBC.

In 2012 there were concerns about the numbers of senior staff in the civil service being employed through a PSC. In May the then Chief Secretary to the Treasury, Danny Alexander, gave details of a review of these arrangements, and of changes to the way departments could appoint individuals ‘off payroll’. The Minister also announced a consultation – foreshadowed in the 2012 Budget – on amending IR35: in brief, anyone providing their services through a PSC who had been taken on with a senior, controlling role for their client would be taxed as an employee. In December that year the Government announced it would not proceed with this proposal “because HMRC’s new approach to policing IR35, along with the measures introduced in the public sector this year, are sufficient to prevent the loss through disguised employment in this way.”

There have also been concerns about the numbers of contractors working for the BBC providing their services through their own PSC, and the corporation’s past practice in encouraging individuals to work this way – arguably without giving staff ample warning of the risks of their placement falling under IR35. The issue was considered by the Digital, Culture, Media & Sport Committee as part of its inquiry into BBC pay over 2018-19, as well as being the subject of an investigation by the National Audit Office over summer 2018, and a report published by the Public Accounts Committee in April 2019.

Since 2014 there have been several initiatives to tackle the misuse of PSCs for tax avoidance, including a reform in the way the IR35 rules work in the public sector.

Several other measures have been introduced to prevent this corporate form being used for avoid tax. First, in the 2014 Budget the Coalition Government confirmed proposals to tackle the use of offshore intermediaries to avoid tax, and to prevent agencies based in the UK using contrived contracts to disguise employment as self-employment. Second, in November 2015 the current Government announced that from April 2016 it would

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10 op.cit. p8
11 HC Deb 23 May 2012 cc1159-70; HC Deb 23 May 2012 cc67-8WS; HMRC, Consultation into the Taxation of Controlling Persons, 23 May 2012
12 Autumn Statement, Cm 8480, December 2012 para 2.103
13 DCMS Committee, BBC Annual Report and Accounts 2017/18: Equal pay at the BBC, HC 993, 25 October 2018
14 National Audit Office, Investigation into the BBC’s engagement with personal service companies, HC 1677, 15 November 2018
15 Public Accounts Committee, BBC and personal service companies, HC 1522, 5 April 2019
16 Budget 2014, HC 1104, March 2014 paras 2.194-5
restrict tax relief for travel and subsistence expenses for workers engaged through an employment intermediary” where the intermediaries legislation applied.\textsuperscript{17}

Third, in the 2016 Budget Government proposed that from April 2017 public sector bodies would have new duty to ensure any contractors that they took on were complying with IR35.\textsuperscript{18} A consultation exercise was launched in May 2016, and in the 2016 Autumn Statement the Government confirmed it would proceed with this reform.\textsuperscript{19} It was estimated that this reform would raise around £890m over the period 2017/18 to 2021/22.\textsuperscript{20} At the time the Government ruled out adopting the same approach to the application of IR35 in the private sector, or introducing a new test for applying IR35 based on the length of the contractor’s contract.\textsuperscript{21}

Following reforms to the application of IR35 in the public sector, the Government has introduced legislation to make similar changes for the private sector to take effect from April 2021.

With the implementation of the reforms to the operation of IR35 in the public sector, there was considerable speculation that the Government would extend the new duty for contractors’ clients to the private sector at some point.

In the Autumn 2017 Budget the Government announced it would “carefully consult on how to tackle non-compliance in the private sector, drawing on the experience of the public sector reforms.”\textsuperscript{22} This consultation was launched on 18 May 2018, and closed on 10 August.\textsuperscript{23} The consultation paper stated that extending the public sector reform to the private sector is the Government’s lead option, though it noted “public authorities faced challenges in implementing the reform and that this is a concern for businesses and individuals working in the private sector.”\textsuperscript{24}

Alongside the consultation document, HMRC also published a short factsheet on the proposed reform,\textsuperscript{25} and details of an independent review it had commissioned on the impact of the public sector reforms on client organisations.\textsuperscript{26}

In his 2018 Budget the then Chancellor Philip Hammond confirmed that the Government would proceed with this reform, but the new rules would come in from April 2020 and apply to large and medium-sized businesses only.\textsuperscript{27} At this time the Government confirmed it would undertake a further consultation on the detailed operation of the new rules. This second consultation was launched on 5 March 2019, and closed on 28 May.\textsuperscript{28}

The Government published draft legislation to be included in the next Finance Bill on 11 July 2019, including provisions to this effect, as well as a summary of the responses made.\textsuperscript{29}

\textsuperscript{17} Autumn Statement, Cm 9162, November 2015 para 3.20; Budget 2016, HC901, March 2016 para 2.39
\textsuperscript{18} Budget 2016, HC901 March 2016 p43; HMRC, Off-payroll working in the public sector: March 2016
\textsuperscript{19} Autumn Statement, Cm 9362, November 2016 para 4.11. Provision to this effect is included in the Finance Act 2017 (specifically section 6 and Schedule 1).
\textsuperscript{20} HMRC, Off-payroll working in the public sector: changes to the intermediaries legislation, 8 March 2017
\textsuperscript{21} Off-payroll working in the public sector: reform of the intermediaries legislation, May 2016 pp36-8
\textsuperscript{22} Autumn Budget 2017, HC 587, November 2017 para 3.7
\textsuperscript{23} HM Treasury press notice, Government to consult on tax avoidance in the private sector, 18 May 2018. See also PQs 150081-2, 13 June 2018
\textsuperscript{24} HM/T HMRC, Off-payroll working in the private sector: consultation document, May 2018 pp22
\textsuperscript{25} HMRC, Factsheet: off-payroll working in the private sector, updated June 2018
\textsuperscript{26} HMRC, Off-payroll reform in the public sector: HMRC Research Report 487, May 2018
\textsuperscript{27} HC Deb 29 October 2018 c661. see also, HM/T HMRC, Off-payroll working in the private sector: summary of responses, October 2018
\textsuperscript{28} HMRC, Off-payroll working rules from April 2020, March 2019. Treasury Minister Mel Stride made a statement on publication: HC Deb 4 March 2019 cc736-7.
to the consultation, and a factsheet summarizing the changes to be made and the Government’s case for reform.

Although IR35 was not a major feature of the 2019 General Election campaign, all of the main parties stated that they would ‘review’ these reforms to IR35. On 7 January 2020 Treasury Minister Jesse Norman, announced a review to “address any remaining concerns from businesses and individuals about how the upcoming reform will be implemented.”

The outcome of the review was published on 27 February, when the Government confirmed a number of changes to smooth the implementation of this reform. The Chancellor Rishi Sunak did not mention IR35 in his Budget statement on 11 March 2020, although the Budget report reiterated the Government’s view that, “it is right to address the fundamental unfairness of the non-compliance with the existing rules, and the reform will therefore be legislated in Finance Bill 2020 … as previously announced.”

However, on 17 March 2020 Treasury Minister Steve Barclay announced to the House that the Government had taken the decision to defer the implementation of this reform for one year, to April 2021, “in response to the ongoing spread of Covid-19 to help businesses and individuals.” Provision to this effect is now included in the Finance Act 2020 (specifically section 7 and Schedule 1 of the Act). It is estimated that this reform will raise around £3.8 billion over the period 2020/21 to 2025/26.

Since the passage of this legislation Ministers have opposed any further delay, and HMRC have published details of how it will support affected organisations to comply with these changes. This guidance states, “customers will not have to pay penalties for inaccuracies in the first 12 months relating to the off-payroll working rules, regardless of when the inaccuracies are identified, unless there’s evidence of deliberate non-compliance.” Following concerns that contractors who start to pay under IR35 from this April would be assessed for earlier years, the guidance also underlines that HMRC “will not use information acquired as a result of the changes to the off-payroll working rules to open a new compliance enquiry into returns for tax years before 2021 to 2022, unless there is reason to suspect fraud or criminal behaviour.”

This paper discusses the history to these developments, concluding with a detailed discussion of the most recent proposals to reform IR35. A second paper looks at the introduction of IR35 and its first years of operation.

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29 Written statement HCWS1713, 11 July 2019; HMRC, Rules for off-payroll working from April 2020, 11 July 2019. An updated & revised version of HMRC’s impact note was published on 3 March 2021.
30 Subsequently HMRC collated guidance material for members, clients and customers at: HMRC, Off-payroll working rules: communication resources, 19 January 2021.
31 “Main parties pledge to review IR35 tax reforms after election”, Financial Times, 4 December 2019
32 PQs900051-2, 7 January 2019; HM Treasury press notice, Off-payroll review launched, 7 January 2020
33 HM Treasury press notice, Government to help businesses with off-payroll working rules, 27 February 2020
34 HC Deb 11 March 2020 cc278-293
35 Budget 2020, HC 121, March 2020 para 2.178
36 HC Deb 17 March 2020 cc905-6
37 HM Treasury, Budget 2021: Table 2.2, Measures announced at Spending Review 2020 or earlier that will take effect from March 2021 or later; March 2021 (item e). Annual receipts are estimated to be: £30m (2020/21); £1,020m (2021/22); £590m (2022/23); £650m (2023/24); £725m (2024/25); £805m (2025/26).
38 PO151599, 22 February 2021
39 HMRC, Supporting organisations to comply with changes to the off-payroll working rules (IR35): issue briefing, 15 February 2021
40 Personal service companies: introduction of IR35, Commons Briefing Paper CBP914, 6 September 2018
1. IR35: the intermediaries legislation

Individuals offering their services to a succession of clients often do so by using an ‘intermediary company’. There are two broad types of intermediary, relating to the amount of control the worker has over the financing and management of the company: personal service companies (PSCs) and managed service companies (MSCs). Individuals using a PSC to sell their services are usually the director of the company as well, with full control over the business. By contrast MSCs are usually operated by a scheme provider who may run a large number of these one-person companies; the worker him or herself has no control over the business.

Channelling the profits of the company through the company offers certain tax advantages compared with working as the employee of a client, and having income tax and NICs deducted by the employer under PAYE. However, during the 1990s the tax authorities became concerned that in many cases individuals were simply using this corporate form as a cover, and looking more closely at the terms and conditions under which they were working showed that they were for all intents and purposes employees.

In a review of the taxation of small businesses, prepared for the ‘Mirrlees Review’ of the UK tax system published in 2011, Claire Crawford and Judith Freedman examined the tax advantages to individuals working in this way:

The main tax advantages of incorporation as compared with employment and self-employment are threefold. First, corporate tax rates are lower than income tax rates … This means that shareholders of owner-managed companies, in particular those in the higher tax rate bracket, may shelter income for investment by the company, having paid only corporation tax on it at a lower rate than income tax. Eventually they will have to pay income tax if they take any gains as dividends, but if they sell or liquidate the company they may be able to convert some part of their income to a capital gain, which is generally taxed at lower rates.41

Second, incorporation provides an opportunity to convert income from labour into income from capital, which enables shareholders to take income from the company in the form of dividends or capital gains not subject to NICs.

Third, incorporation may offer the opportunity for an owner to split shareholdings with other family members so that the whole of the income is taxed at a lower rate than would be the case if it was all received by one shareholder …

To give an example of the interaction between these factors, in the case of a one-person company the lowest possible tax rate combined with benefits entitlement is achieved by the company paying the single owner-manager a low salary (equivalent to their personal allowance (tax free threshold)). The company then either retains profits which are taxed only at the small companies’

41 [Many intermediary companies would not have this option because they would have to pay out much of the corporate income for living purposes.]
corporation tax rate, or pays them out by way of dividends, which are not subject to NICs and which also carry a credit for corporation tax paid.

For example, in 2008–09, applying this method means that an incorporated owner-manager whose business makes £25,000 gross annual profits pays only 16.1% (£4,035) of this in tax, compared with 27.0% for an employee and 21.9% for a self-employed individual earning the same amount ... To improve their tax position further, the owner-manager could also give shares in his company to other family members and distribute dividends accordingly.42

Although there have been reforms to corporate and personal taxation since the Mirrlees Review,43 there remain considerable tax incentives for individuals to work through PSCs rather than being engaged as employees – both for the individual and their client company. In 2014 HMRC published research it had commissioned that suggested that the potential income tax and NICs savings from operating a PSC was one of key reasons why individuals chose to incorporate.44

In July 2017 the Office for Budget Responsibility looked at the impact of the Exchequer from the growth in the numbers of self-employed and owner-manager or single director companies, discussing the different tax treatment of these three kinds of engagement; an extract is reproduced below:45

Employees make up the vast majority of the UK workforce and are characterised by working under an employment contract and having a variety of legal rights such as statutory sick, maternity, paternity and redundancy pay. Their employer must pay Class 1 employer NICs of 13.8 per cent on their wages above the relevant threshold. Their net earnings (excluding employer NICs) are liable to income tax as well as Class 1 employee NICs. Both are collected through the PAYE system.

Self-employed individuals run their own businesses, reporting the profits as income and having more flexibility to deduct business expenses. They pay income tax at the same rates as employees, but are only liable for Class 4 NICs. These are paid at a lower rate than employee Class 1: 9 versus 12 per cent on income below the higher rate income tax threshold. The Class 4 NICs rate increases in Spring Budget 2017 would have reduced this differential, but were abandoned soon after. The self-employed pay tax and NICs liabilities via self-assessment returns due nine months after the end of the financial year.

Working as a director and employee of a very small limited liability company has been possible for many years, but became much easier when the 2006 Companies Act abolished the need for a company to contain at least two individuals (a director and a

43 For example, in 2008/09 the rate of corporation tax was 28%, but 21% for companies with profits below a small profits threshold. With a series of cuts in the main rate, all onshore companies are now charged a single 19% rate (see HMRC, Corporation tax rates – Table A6, 2018).
distinct company secretary). A single director of a company, or a company with a small number of closely linked directors, can run their business very similarly to the self-employed, but also enjoy the benefits of limited liability status.

Company directors can minimise their tax burden by paying themselves (as the sole ‘employee’) a wage up to the primary threshold at which employee and employer NICs become liable. As this threshold is below the personal allowance, it also incurs no income tax. This wage can then be deducted from the company’s gross profits, the remainder of which are liable to corporation tax (currently 19 per cent, but set to fall to 17 per cent in April 2020).

Post corporation tax profits can then be withdrawn as dividend income for the sole shareholder (the director), which is liable for tax at lower rates than other types of income and attracts its own tax-free allowance (currently £5,000, but set to fall to £2,000 in April 2018). Directors can also benefit by retaining profits within the company, paying the lower entrepreneurs’ relief rate of capital gains tax (of 10 per cent) upon selling it.

The result of this varying tax treatment is that three people doing very similar work can face very different tax liabilities depending on their form of employment. Imagine a contract being offered for a piece of work (e.g. building a website) offering £50,000 as compensation in 2017-18, with this being the only source of income during the year for the individual concerned.

Chart 5.12 shows how much of that £50,000 would be paid in tax depending on whether it was carried out by an employee of a medium-sized company, a self-employed individual or a single-director company.

Chart 5.12: Tax due on £50,000 of income in 2017-18

The employee faces the largest tax burden, paying 32.3 per cent of the £50,000 income in tax or NICs. That compares with 24.5
per cent for the self-employed individual and 19.7 per cent for the sole director of his or her own company.\textsuperscript{46} The biggest difference comes from employer NICs for employees. Despite this being paid by the employer, we include it in the individual’s tax burden because it directly reduces the amount available for the employee’s wage. Single-director companies benefit mainly from the lower rates of corporation tax and dividend tax.

As noted in this extract, in the 2017 Budget the Government had proposed increasing the rates of NICs paid by the self-employed, to reduce the NI differential with respect to employees but abandoned these plans. Further details on this separate, if related issue, are in another Library briefing paper.\textsuperscript{47}

In 2000 the Labour Government introduced provisions to prevent the use of PSCs converting labour income into dividend income – the IR35 rules, or the ‘intermediaries legislation’.\textsuperscript{48} Equivalent provisions to counter the exploitation of MSCs were introduced in 2007.\textsuperscript{49}

Broadly, [IR35] applies to those engagements where –

- you personally perform services for another person (the client);
- the services are provided not directly with the client but under arrangements involving an intermediary; and
- the circumstances are such that, if you had provided the services directly to the client under a contract between you and the client, you would have been regarded for income tax purposes as an employee of the client and/or, for NICs purposes, as employed in employed earner’s employment by the client.

In addition you must receive or have rights entitling you to receive a payment or benefit that is not employment income …

It is therefore necessary under the legislation to construct a \textbf{hypothetical contract} between the worker and the client based on all the circumstances including the terms and conditions of relevant contracts and the actual substance of the arrangements that would have existed had the PSC not been used.

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\textsuperscript{46} These calculations assume the individual has only one source of income. The deduction of employer NICs means that less of an employee’s total compensation is made up of their wage, thereby paying less income tax but more NICs than the self-employed. Company directors are assumed to withdraw profits in the most tax efficient way, paying themselves a salary up to the primary threshold for NICs, and taking the rest as dividends, all in the same year.

\textsuperscript{47} National Insurance Contributions (NICs) and the self-employed, Commons Briefing paper CBP7918, 21 December 2018

\textsuperscript{48} The provisions formed s60 & schedule 12 of the Finance Act 2000. They are now consolidated in the Income Tax (Earnings & Pensions) Act (ITEPA) 2003: specifically, chapter 8 to part 2 of the Act (ss48-61). For details see HMRC’s Employment Status Manual, specifically from para ESM8000.

\textsuperscript{49} For background on this reform see, Managed Service Companies, Commons Briefing paper CBP4301, 27 April 2020.
between the parties. Subject to meeting the other conditions, if that hypothetical contract would be one of service then the engagement is within the legislation.\(^50\)

In their contribution to the Mirrlees Review, Claire Crawford and Judith Freedman explain how IR35 removes the potential tax advantage to working through a PSC:

Where these rules apply, the client pays the PSC gross. Salary paid by the PSC to the worker is subject to PAYE and NICs rules in the usual way. In addition, to the extent that the PSC does not pay out its entire earnings as salary, the PSC is treated as paying a further salary of this retained sum to the worker. Benefits in kind paid to the PSC are taxed in the same way as employee benefits and the restrictive employee deduction rules are applied to expenses. Relief is given to prevent double taxation, and a small deduction is allowed for expenses of running the PSC.

The impact of the tax liabilities is on the individual worker and not the client, however, so that there has been no reduction of the incentive to large businesses to insist that those providing services to them incorporate. Initially the legislation was designed to put some of the onus onto the clients and this might have altered behaviour but, following business complaints, the liability was placed on the PSC itself.\(^51\)

Writing more recently in the *Tax Journal*, Ian Hyde and Chris Thomas (Pinsent Masons) identify an additional advantage for clients who engage a PSC rather than contracting directly with a self-employed individual:

One big advantage to the client in contracting with a PSC, rather than a self-employed individual directly, is that if HMRC disagrees with the individual’s tax status, barring the PSC being a sham, HMRC has to pursue the PSC for the tax and not the client.\(^52\)

Generally for the purposes of tax law, individuals may be classified as either employees or self-employed. (Employment status for the purposes of employment law additionally distinguishes ‘workers’ who have fewer rights than employees – and this issue has been central to the recent debate on the implications of the ‘gig economy’.\(^53\) Determining employment status in individual cases can be complex,\(^54\) and, as Claire Crawford and Judith Freedman noted in the Mirrlees Review, this has important implications for the operation of IR35:

The boundary [between employment and self-employment] is defined in law through a series of decided cases based on certain characteristics or ‘badges’ of employment status. These badges include such matters as the degree of control over the worker, the level of risk he undertakes, the amount of equipment he provides and whether he is integrated into the business in any way. Each factor varies in importance depending on the circumstances.

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\(^{50}\) HMRC, *IR35: the circumstances in which the legislation applies*, February 2014


\(^{52}\) “Off-payroll in the private sector”, *Tax Journal*, 1 June 2018

\(^{53}\) see, *Employment status*, Commons Briefing paper CBP8045, 28 March 2018

\(^{54}\) see, *Self-employment in the construction industry*, CBP196, 23 August 2019
The case law has made some movement to recognize that the tests of control and provisions of equipment are now less important than they once were in defining employment. The test does not offer a clear dividing line, however, and is very fact based. This limits the amount of guidance provided by the court decisions. While this keeps the law flexible and ensures that it can develop with changing conditions, it also makes it uncertain and difficult in terms of administration and compliance.55

The authors suggest that the requirement for PSCs to construct a hypothetical contract placed a "heavy reliance on the finding of a legal relationship of employment, on which the law can be very unclear in borderline cases":

[As IR35 does not reduce the financial incentives for client companies to insist that workers use a PSC] thus it is that some workers find themselves in a situation in which they must incorporate in order to obtain work, or are starting up with only one client with a view to development, but, in these circumstances, are vulnerable to this complex anti-avoidance legislation. Arguably, the involvement of the problematic employee status test in the determination of whether IR35 applies has made the legislation unworkable, unenforceable, and uncertain in its application …

Taxpayers covered by this provision also pay tax as employees but without the benefits of employment. This could be the worst possible outcome, since it remains a trap for the unwary and increases compliance costs and encourages costly structuring to avoid the legislation, but is unlikely to raise very much revenue.56

In June 2010 Taxation reported on a case where the Tribunal ruled in favour of the taxpayer in an appeal which concerned a series of contracts undertaken when IR35 was first introduced.57 Writing in the magazine in July 2018 Alastair Kendrick noted “on a personal note it is unfortunate that despite the IR35 legislation being in place for many years, so few cases have been heard by the courts. As a result there is no established case law to follow and many contractors are relying on the opinion of advisers and recruiters.”58

55 Dimensions of tax design: the Mirrlees Review, 2010 p1044
56 op.cit. p1051
57 “An unexpected victory”, Taxation, 10 June 2010
2. Review of IR35 by the Office of Tax Simplification (2010-11)

The Coalition Government set out its priorities for taxation in its agreement published in May 2010. In this the new Government stated that it believed “the tax system needs to be reformed to make it more competitive, simpler, greener and fairer” and in particular that it would “review IR35, as part of a wholesale review of all small business taxation.”

In its first Budget in June 2010 the Coalition Government confirmed that it “remained committed to a review of IR35 and small business tax” and the next month announced that this would be one of the first projects of a new independent body to advise on tax reform: the Office of Tax Simplification.

The terms of reference for this review gave a little more detail on the work the OTS was expected to produce on IR35 – an extract is reproduced below:

In conducting this review, the Office will provide an initial report to the Chancellor by Budget 2011 that:

- examines evidence and identifies the areas of the tax system that cause the most day-to-day complexity and uncertainty for small businesses;
- recommends priority areas for simplification; and
- considers the impact of any simplification in these areas on different business sectors, including large business.

Once the Government has considered the initial report the Office will be asked to produce specific recommendations on tax simplification for small businesses.

**IR35 legislation**

The Government has already indicated that reviewing IR35 legislation is a priority and that it will seek to replace it with simpler measures that prevent tax avoidance but do not place undue administrative burdens or uncertainty on the self-employed, or restrict labour market flexibility.

Therefore, in its initial report to the Chancellor, the Office should also:

- identify and provide evidence of the complexity and uncertainty created by IR35;
- consider alternative legislative approaches that would be simpler and create certainty while ensuring that, where intermediaries are used to disguise employment, any income that is effectively employment income is taxed fairly; and

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60 HC 61 June 2010 para 1.69
61 HM Treasury press notice 29/10 20 July 2010
• consider the scope for tax avoidance and the extent to which alternatives to IR35 would affect it.

The focus of this work should be exploring alternatives to IR35. However, the Government will be interested in issues in relation to the structure of the tax system and the employment status test more generally. This may have a bearing on wider issues about employment status and the boundary between employment and self-employment, including the impact on larger businesses.62

The next month the new director of the OTS, John Whiting, was interviewed by the then editor of Taxation, Mike Truman. One of the issues Mr Truman raised was the Office’s work on IR35, and in response Mr Whiting noted that the immediate abolition of IR35 from the statute books was highly unlikely, arguing “for all the hot air it generated, there were real abuses that IR35 was meant to tackle. If it were abolished, they could come out again”:

Mike Truman (MT): How far will the small business review go? As soon as you pull at one string of it, you could unravel the whole lot.

John Whiting (JW): Well, it specifically includes IR35, and a lot of people have already interpreted that as ‘we’re going to abolish IR35’. Now, just a minute: in some ways that’s not a bad starting point: i.e. can we at least streamline IR35? But if we’re going to make any serious progress we should look at the whole thing. Does that mean looking at the whole subject of sole trader v employee v company? Yes, it possibly does. We might have to come up with an initial report that says we’ve got to look at the whole thing to make a real impact.

MT: So, without asking you to be definite, you’d be reasonably happy if by Budget 2011 you had outlined the scope for a further consultation?

JW: That’s clearly one possibility, but I’ll be hoping for a lot of input between now and then from people who have been thinking about it for some time. So, perhaps we can plot more of a course. What I don’t want to do is add another bit of sticking plaster to what is already quite a ramshackle structure. If that disappoints people by not committing to abolish IR35 by the end of the week, well, sorry.

MT: Even if IR35 is abolished in due course there is still that fault line to deal with between casual employees and freelance workers. One way to abolish it would be to come up with tests like those planned for the construction industry.

JW: Or you start removing the differential between these different statuses. I don’t want to rule anything out or anything in at this stage, but we need an overall look at this. As far as I am concerned, IR35 is not very effective and we need to look at what gives rise to that. For all the hot air it generated, there were real abuses that IR35 was meant to tackle. If it were abolished, they could come out again. Maybe people have to accept that if we simplify to make things easier, it may make some of the edges rougher.

MT: Would that involve divorcing the employed/self-employed distinction for tax from the one used in other legislation?

62 These terms of reference are published with the OTS’ review on Gov.uk.
JW: Personally, I wouldn’t want to do that. I’d prefer to get them harmonised and going in the same direction. IR35 was also meant to ensure that those who really were employees got employment benefits, but that never happened.63

A few days before the 2011 Budget the OTS published an interim report on simplifying small business taxation. Introducing this work Mr Whiting noted “we’ve suggested ways forward on … IR35, though it’s clear there is no easy solution there.”64 The then chairman of the OTS, Michael Jack, noted in the foreword to the report, “of all the topics we tackled, [IR35] proved the thorniest”:

It encapsulates the tension between HMRC, who are tasked with applying the tax code in order to protect and gather revenues, and individual businesses who see IR35 as a barrier to them running profitable small enterprises with all the risks that this involves.65

The report took the position that “genuine and long-lasting simplification can only be brought about through major structural change” and, with particular relevance to IR35, suggested that the Government should look at the integration of income tax and NICs. Of course by reducing the differential between the rates of tax charged to different incomes and legal forms, this change could “remove much of the pressure on the employment and self-employment boundary and should result in the IR35 legislation being obsolete.” However, given the magnitude of this change the authors went on to make a number of other suggestions for improving IR35 in the medium term: introducing a new ‘business test’ to bring clarity to the exact scope of the rules; improving the administration of the rules; or, suspending the rules to monitor what preventative function they actually served.66

Notably the OTS found there was “no reliable data … as to the current numbers affected by IR35”, though “HMRC data from forms P35 [the annual tax return employers must complete] in 2007/08 and 2008/09, show that 70,000-75,000 declare themselves as service companies annually. Of these, 30,000 applied IR35 or the Managed Service Company legislation in 2007/08, while in 2008/09 this number had dropped to 9,500.67” Further to its discussions with the industry, Treasury and HMRC, as well as reviewing practice in other countries, the OTS argued that “there is probably no clear cut legislative alternative that addresses the concerns of all the parties … [but in many] instances IR35 as it stands is not effective, either for the individuals affected or for the Exchequer.” In its view there were three lead options to improve the current situation (emphasis added):

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63 “All to play for”, Taxation, 4 August 2010
64 OTS press notice, Initial simplification ideas for small businesses tax unveiled, 10 March 2011
65 Office of Tax Simplification, Small business tax review, March 2011 p3
66 Small business tax review, March 2011 pp5-6
67 Concerns have been raised with this data as the questions are reported to have caused difficulties. Some ignored the questions on the basis that there is no legal definition of a “service company” or that answering the questions would trigger an IR35 investigation. HMRC’s service company definition is also wide enough to capture small incorporated companies, for example, an accountancy practice with multiple clients, premises and staff not affected by IR35.
From the perspective of simplification, **abolition of IR35** delivers the greatest improvement, providing individuals with certainty over tax status and removing legislation … The OTS’s view is that a commitment from the Government to the integration of income tax and NICs, would lead to a reduction in the tax motivation for incorporation, and would limit the long term cost of this option. … The largest element of the fiscal risk is likely to come from the incorporation of current employees and the movement of workers out of umbrella companies. This may be exacerbated by the squeeze on salaries in the current economic climate and the aggressive marketing strategies used in the IR35 industry to encourage individuals to incorporate. The OTS is not in a position to calculate the amounts at risk but it could clearly be significant; work on the figures is needed and must be realistic …

Many people have told the OTS that after 10+ years of experience, the burden of IR35 has fallen, simply because it is well known. Individuals organise themselves to fall outside as a matter of routine … **Improving HMRC’s IR35 administration** processes will deal with the issues raised to OTS including the fear of investigation, the length of time an investigation takes and will enable individuals to self certify their IR35 status with certainty saving time and costs. This option would also address the lack of consistency by HMRC in handling IR35 cases …

[Alternatively the Government might] consider the introduction of a genuine business test to exempt certain businesses from IR35 entirely. This proposal would establish a range of simple tests that those within the ambit of IR35 could apply to their situation and be able to depend on the outcome through having a ‘safe haven’. This aim would be that the great majority (90%+) of such businesses would know that they were outside IR35, and attention (of advisers, businesses and HMRC) could focus on the remainder. The test would be in addition to the current rules and the uncertainty these create.

The OTS received views from some of our Consultative Committee in support of this option and some very strong views against, on the basis that it adds another layer of complexity and is therefore not a simplification. The key problem would be how the tests were defined. To give one illustration, consider the one that suggests that a business with X or more customers would be outside IR35. How would customer be defined? A common sense definition could work, but what happens when a legal challenge is mounted? What sales would a customer have to receive to count?68

The report gives further background to the history of IR35 and analysis of these policy options – though, as Mr Jack noted in the report’s foreword, “no one method of reform currently commands universal support … any future decision on, for example, abolishing IR35 altogether would require underpinning by a much better quality of data than presently seems to be available.”69

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68 Small business tax review, March 2011 pp39-42
69 Small business tax review, March 2011 p3 For further analysis see Annex C to the report (pp51-65)

In the run-up to the 2011 Budget there was some speculation that the Government was going to announce a wholesale merger of income tax and NICs, along the lines suggested by the OTS. This was not to be. In his Budget speech on 23 March 2011 the Chancellor, George Osborne, announced that the Government would consult on merging the operation of income tax and NICs; the Chancellor went on to make clear that any reforms would not result in NICs being extended to other forms of income, or the end of the contributory principle:

For decades, we have operated income tax and national insurance as two fundamentally different taxes and forced businesses large and small to operate two completely different systems of administration, with two different periods and bases of charge. The resulting anomalies are legion, and it imposes totally unnecessary costs and complexity on employers and costs the taxpayer in the extra burden that it places on Her Majesty’s Revenue and Customs.

So I am announcing today that the Government will consult on merging the operation of national insurance and income tax. I am not proposing that we extend national insurance to pensioners, or to other forms of income, or that we abolish the contributory principle. Our purpose is not to increase taxes; it is to simplify them, and this huge task will therefore require a great deal of consultation and take a number of years to complete, but it is time we took this historic step to simplify dramatically our tax system and make it fit for the modern age.70

Further to this in the Budget report the Government announced that IR35 would be retained “as abolition would put substantial revenue at risk.” However it was committed to making “clear improvements in the way IR35 is administered.”71

There was relatively little comment on this issue in the first reactions to the Budget, though the then editor of Taxation, Mike Truman, wrote a piece strongly critical of the Government’s decision not to merge income tax and NICs: “at a stroke … any prospect of removing tax-driven incorporation has been removed … without extending NICs, either as a retained separate charge to maintain the contributory principle or as part of a merged tax, there is no solution to the business vehicle problem”:

[Of the options for reforming IR35 set out in the report, the Government has gone for] … retaining IR35 but improving its administration. This will involve a dedicated helpline to offer ‘greater pre-transaction certainty’, more guidance on the cases HMRC consider to be outside the scope of IR35, and to restrict reviews to high-risk cases which will be handled by specialist teams. Again, this would have been fine as a temporary solution on the basis that IR35 would shortly become irrelevant once the merger of tax and National Insurance had happened. But as a

70 HC Deb 23 March 2011 cc954-5
71 Budget 2011, HC836 March 2011 para 2.203
permanent solution it is hardly likely to be satisfactory …I don’t want to give the impression that the Small Business Review has achieved nothing. There has never previously been any progress at all on the road to integration of tax and NI; even the limited amount of progress which the Budget documents suggest would be worthwhile.

Just making NI cumulative and aligning thresholds and definitions would be a significant step, albeit that when employees realise this might mean them paying NICs on benefits in kind, things are likely to turn a little nasty. But, to state the obvious, the OTS report was a review of small business taxation, not of tax and NI integration. The reason that the latter keeps coming back onto the table is because it is the only obvious way to remove the fault lines between personal service companies, self-employment and employment. As I read it, the Budget has failed to catch this political hot potato, and has blocked from the start any possibility of true integration of tax and NICs. I can only hope that I am wrong, and that once the first steps of integrating the operation of the two charges is underway, the government will be prepared to revisit the reform that we really need.72

In a letter to the OTS in May 2011 Treasury Minister David Gauke stated that he had asked the department “to undertake a thorough overhaul of the administration of this area of the tax system”; the Minister’s letter gave more details on the Government’s rationale:

The OTS report highlights that integrating income tax and NICs and reducing the difference between the tax rates on different incomes and legal forms could result in the IR35 legislation becoming obsolete. However, recognising the long timescale for introducing any major structural changes, your report also suggests three options on IR35 that could be introduced in a relatively shorter timescale.

The first option presented in the OTS report is to suspend IR35 with a view to potentially abolishing it in the longer term. I share your view that purely from the perspective of simplification this would be a positive step. However, as you acknowledge, in places IR35 remains an effective deterrent and the fiscal risks of suspension are both significant and immediate. In light of this, the Chancellor and I concluded that suspension was not the right option.

The OTS report identifies two alternatives to suspension, the first to improve the administration of IR35, and the second to replace it with a business test. In the context of IR35’s administration, your report highlights that after more than ten years of experience the burden of IR35 has fallen, although it is apparent that a genuine fear of the legislation remains within the freelance workforce. When considering the options you presented, it was clear to me that a fresh look at how HMRC administer IR35, as the OTS suggests, would bring about improvements to the current situation. I could also see that replacing IR35 with a business test could provide an opportunity to give businesses greater certainty - but I came to the conclusion that it would be very challenging to devise a test that would work for business and HMRC.

As the OTS report confirms, there is no easy answer on IR35. The Chancellor and I carefully weighed the options you presented in making our decisions at Budget. Reflecting this, and the

72 “Missing the catch”, Taxation, 7 April 2011
substantial risks from suspension of the legislation, we decided that the best option is to retain IR35 with a commitment to achieve clear improvements in administration.

I have asked HMRC to undertake a thorough overhaul of the administration of this area of the tax system. HMRC will focus on providing pre-transaction clarity and certainty and restoring trust. The changes to be made will include setting up a dedicated helpline staffed by specialists, publishing guidance on those types of cases HMRC view as outside the scope of IR35, targeting compliance activity by restricting reviews to high risk cases and setting up an IR35 Forum which will monitor HMRC’s new approach. To ensure consistency, HMRC have invited candidates drawn from those involved in the OTS review of IR35 review, to participate in this forum. Overall, I hope the OTS will be able to endorse this approach, which I believe has real potential to remove much of the uncertainty and to improve transparency for business.73

For some critics of IR35 the Government’s decision must have been a considerable disappointment, although the Professional Contractors Group – a lobby organisation that was set up initially in response to IR35 being introduced – welcomed the establishment of the IR35 Forum, mentioned in the Minister’s letter. In a press notice issued by the Group, their chairman, Chris Bryce, said: “with the IR35 Forum, we have a chance to make a real difference to the uncertainty around IR35 and issues such as the unacceptable length of many IR35 investigations. We take this challenge very seriously and are determined to deliver clarity, transparency and consistency for our members and the freelance community. We are determined to clean up HMRC’s administration of IR35 once and for all.”74 The Forum was established the next month.75

One outcome of this forum was the department publishing some guidance in May 2012 on how it applies these rules in practice – which included a series of ‘Business Entity Tests’: a number of questions based on twelve aspects to the way a business was operating (such as its premises, or its advertising) to illustrate if the business concerned was likely to fall under IR35.76 In answer to a PQ in November 2012, the Treasury Minister David Gauke said that following this, “initial indications show a positive improvement in HMRC’s administration of IR35.” Mr Gauke went on to say, “HMRC will be reviewing their new approach to IR35 during summer 2013. The results and any findings of this review will be initially shared with the IR35 Forum and published once they have been finalised.”77

The department’s approach to administering IR35 was criticised in a report by a House of Lords Committee, established by the House on an ad hoc basis in November 2013. In their report, published in April 2014, the Committee agreed that the abolition of IR35 would be unwise “if

73 Letter from Exchequer Secretary to Michael Jack, Chairman, OTS, 9 May 2011
74 PCG press notice, Treasury Minister commits to working with freelancers for real improvements to IR35, 5 May 2011
75 Details of the Forum’s work are on Gov.uk.
77 HC Deb 29 November 2012 cc435-6W
the legislation has the Exchequer protection effect claimed for it by HMRC”, though it raised doubts about these revenue estimates, and suggested the guidance offered by HMRC for taxpayers was “far from satisfactory”:

Her Majesty’s Revenue and Customs (HMRC) told us that such a measure would put £550 million of revenue at risk. This figure is an estimate and was not, in our view, directly substantiated by any publicly available information. Given that the justification for maintaining the IR35 provisions relies almost entirely upon this calculation of a deterrent effect, we believe that HMRC should publish a detailed assessment to justify maintaining the IR35 legislation.

If IR35 is to be maintained, the guidance which is currently made available to those affected must be improved. We recommend that HMRC undertake a full consultation on how the Business Entity Tests could work better to provide greater certainty to taxpayers. HMRC’s Contract Review Service [a telephone helpline established to advise individuals of the likelihood of a particular contract falling within IR35] needs to be improved; in addition they should provide greater clarity as to the questions asked concerning service company usage on annual tax returns. In addition, the membership of the IR35 Forum should be reviewed.

It is worth noting that the then Exchequer Secretary, David Gauke, declined to give evidence himself, or to have Treasury officials appear before the Committee, on the grounds that the Committee’s enquiry “was concerned with HMRC’s application of the legislation.”

In June 2014 the Government published its response to the report; this included an assessment of the cost of abolishing IR35, which put the direct Exchequer cost at £30m, but the total impact, taking into account the responses of individuals and directors, at £550m. The department noted that, “these behavioural assumptions are inherently difficult to estimate.” The Government’s response to the other principal recommendations, highlighted above, were as follows:

Guidance for taxpayers: “HMRC acknowledges that the IR35 guidance can be improved. A comprehensive review of the guidance has taken place during which HMRC worked closely with stakeholders to understand user needs. The new guidance will be published shortly. HMRC is committed to keeping the guidance under review to ensure that it remains up to date and responsive to user needs” (para 2.48).

The Revenue’s helpline service. The IR35 Forum was set up in 2011/12 as part of a wider review by HMRC of the administration of IR35. Working with HMRC, the Forum is now looking at how the revised administration arrangements have worked and what further improvements can be made. That work includes a review of the Contract Review Service; its use and barriers to its use, and

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78 [HMRC officials gave some details of the methodology in written evidence to the Committee: Select Committee on Personal Service Companies, Oral and written evidence, April 2014 p164]
79 Personal service companies, HL Paper 160 of 2013-14, 7 April 2014 pp54-5, p5
80 op.cit. p8
81 The estimate is for 2010/11. For details see annex 1 to, Personal service companies: the Government’s response, Cm 8878, 9 June 2014 pp13-14.
will report and make recommendations to the IR35 Forum during 2014. The Committee’s recommendations will be considered by HMRC as part of this review” (para 2.46).

The Business Entity Tests: “A review of the Business Entity Tests forms one strand of [HMRC’s] wider review of IR35 administration … HMRC is working … with members of the IR35 Forum to gauge the use and impact of the Business Entity Tests and will report and make recommendations to the IR35 Forum during 2014” (para 2.50).

Questions on the tax return: “working with stakeholders, HMRC will undertake a full review of these questions on the personal tax return (SA100) and RTI end of year declaration: their form, purpose and clarity, with a view to making any necessary changes at the earliest practicable date” (para 2.24).

Membership of the IR35 Forum: “HMRC is committed to working with the Forum, values the feedback the Forum provides, and will look for further ways to demonstrate it is receptive to this feedback. HMRC is also looking at membership of the IR35 Forum as part of the wider review of IR35 administration and will report and make recommendations to the IR35 Forum during 2014” (para 2.54).

Following concerns raised by the IR35 Forum that the Business Entity Tests were being misused, HMRC announced that they would be withdrawn, with effect from April 2015.82 In March 2015 HMRC published an updated assessment of the cost of withdrawing IR35 – which still put the Exchequer impact of abolishing the rules at £550m. It also provided a calculation of the administrative cost to businesses in complying with IR35. In the latter case, HMRC estimated that the annual administrative burden was £16m.83

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82 IR35 Forum: Minutes for Meetings (see minutes for meetings on 24 July 2014 & 5 November 2014). See also, HMRC, Business Entity Tests, May 2012 (archived page).
83 HMRC, IR35: Estimating the administrative burden, 12 March 2015.
4. Off-payroll appointments in the public services (2012)

In early 2012 the practice of individuals using PSCs to mitigate their tax liability came back into the news, with publication of the arrangements made for paying the Chief Executive of the Student Loans Company (SLC), Ed Lester. Mr Lester took his post on an interim basis in May 2010 before taking up a permanent position in February 2011. Initially Mr Lester had been paid through a PSC rather than being paid directly, as the SLC’s 2010/11 Annual Report made clear.  

On 2 February the Government confirmed that PAYE and NICs would be deducted from Mr Lester’s income in future. However, the likelihood that similar ‘off payroll’ arrangements were in place elsewhere in the Civil Service – including the Department for Health - was strongly criticised by Members and in the press. The Chief Secretary to the Treasury, Danny Alexander, announced that he had requested all Departments to carry out an internal audit of appointments by the end of March 2012: “across Government, if any appointments that do not provide value for money are found, whether agreed by this Government or the previous one, I have urged Departments to seek to unwind them as quickly as possible and as quickly as is compatible with securing good value for public money.”

Of course, the existence of a PSC would not show, in itself, that an individual was avoiding tax – this is the purpose of IR35, as noted answer to a PQ sometime after this controversy:

**Mr Gregory Campbell:** To ask the Chancellor of the Exchequer if he will review the use of personal service companies as a means of tax avoidance.

**Mr Gauke:** Personal Service Companies are not in themselves avoidance vehicles and contribute to the flexibility of the UK labour market. Where Personal Service Companies are used for the purpose of avoidance, anti-avoidance legislation: the intermediaries legislation (commonly known as IR35), already exists to ensure the right tax and national insurance is paid where individuals attempt to avoid paying tax and national insurance on what is in effect employment income.

As part of the OTS recommendations set out in their review of small business HMRC has improved the way in which it administers IR35, including strengthening its specialist compliance teams which tackle avoidance of employment taxes, increasing the number of investigations where IR35 is the main risk this year.

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84 Student Loans Company Annual Report 2010/11 p42
85 HC Deb 2 February 2012 cc 995-6
86 For example, “Civil servants’ union chief says tax schemes must stop”, Guardian, 16 February 2012; “Civil servant tax probe widens”, Financial Times, 17 February 2012; EDM 2728 of 2010–12, 20 February 2012; HC Deb 23 February 2012 cc920W & cc929-30W; HC Deb 7 March 2012 cc 737-8W
87 HC Deb 2 February 2012 cc 1001-2
by tenfold and clarifying the application of the legislation to officeholders.88

Notably in the press coverage of Mr Lester’s case, and of similar arrangements at the Department of Health and some primary care trusts, generally there was reference to a potential tax saving made by the individuals involved.

The status of the Government’s review was set out by Treasury Minister Chloe Smith, in her response to a debate on pay and consultants in the public sector in Westminster Hall on 13 March; an extract from her comments is given below:

We do not believe that tax avoidance is appropriate in the public sector. Indeed, it is expressly forbidden in a document entitled “Managing Public Money” … All bodies covered by that guidance are covered by the Chief Secretary’s review … [This] will consider the extent to which use is made of arrangements whereby the tax position of appointees can be perceived to be minimised, and will make appropriate recommendations. The review will include individuals being paid through PSCs.89

The Minister also addressed the separate if related question of IR35, as Cathy Jamieson MP had asked if “the Minister will say … how it will be modernised and changed.”

The hon. Member … will know that in the Budget last year, following a review by the independent Office of Tax Simplification, the Chancellor announced that IR35 would be maintained, but that Her Majesty’s Revenue and Customs will take forward options for improving its administration.90

At the time some in the business community expressed concern that critics had ignored the advantages of PSCs for companies and freelancers, quite separate to the vexed question of tax – though Chris Bryce, the chairman of the Professional Contractors Group, argued that the controversy had demonstrated that IR35 should be reformed:

Chris Bryce, chairman of PCG, which represents freelance workers, said: “We have an almost hysterical witch hunt to clamp down on the very sector in the economy which is actively growing … If you want the right person for the role and it is a temporary role, using a freelancer is a perfectly good way of doing business.”

His words were echoed by Stuart Davis, chairman of the Freelancer and Contractor Services Association, who said: “At a government level, the importance of a flexible workforce is misunderstood. They tend to operate a ‘one size fits all’ mentality. “If it means they are discouraging entrepreneurial methods of getting people into the workforce that would give me concern.”

Representatives of both groups will meet officials at Revenue & Customs tomorrow for the last meeting before the Budget of a task force set up to review the laws preventing paying people through companies if they are in effect a full-time permanent employee. …

88 HC Deb 5 February 2014 c254W. see also, HC Deb 23 February 2012 c930W
89 HC Deb 13 March 2012 c22WH
90 HC Deb 13 March 2012 c22WH
Mr Bryce said: “IR35 is a complete mess. It’s a dog’s dinner and has been since it was introduced in 2000. It is an unworkable piece of legislation and should be repealed.” He recommended shifting the onus of complying with the rules from the employee to the employer.91

A similar point was made by the professional commentator, Simon Sweetman, writing on the AccountingWeb site:

It is of course true that the original IR35 proposals would have placed a responsibility on the “employer” and that heavy lobbying by the major accountancy firms changed this. Whether or not that was the intention at the time, this scattered the problem so widely among a myriad of small companies that it became - as we have seen - impossible for HMRC to police. That is a cause of gross unfairness because detection is simply a matter of luck, and many people who ought to be employees (according to the law) make the reasonable assumption that nobody will ever catch up with them.92

As the department’s review of pay agreements continued, there were press reports that more than 2,000 individuals may have been engaged ‘off payroll’, by providing their services through a PSC.93 In a second piece on AccountingWeb, Mr Sweetman suggested this was not as shocking as some headlines had presented it:

Margaret Hodge [Chair of the Public Accounts Committee] is shocked (and so is Danny Alexander) by the revelation that “2000 senior civil servants are using companies to avoid or mitigate tax”. But is it what it seems? … It would be surprising – and genuinely shocking – if any of these were real career civil servants. Most of them are contractors on short term contracts and it is a fact that some government departments insist on taking them on through companies to avoid creating employment rights: the rest, one suspects, are people brought in from the private sector, who bring their limited companies with them. Such people will not, technically, be civil servants at all…

The recommendation is that everyone taken on for more than six months should go on the payroll (not, you notice, that they should have IR35 status checks, though that would seem the correct way to proceed). It seems that some 40% have been in place for more than two years (though whether on single contracts or repeated short ones we do not know). Much was made of the difficulty of breaking contracts, but surely all departments have to do is ask HMRC for an IR35 ruling. And if – as many of them may be – they are office holders, there is no question but that they ought to be on PAYE.94

In his 2012 Budget the then Chancellor, George Osborne, did not mention this issue, though the Budget report indicated that the Government would consult on reforming these rules from 2013:

The Government will introduce a package of measures to tackle avoidance through the use of personal service companies and to

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91 “Freelance groups lobby over pay rule”, Financial Times, 20 February 2012
92 “Simon Sweetman on IR35 and ethics”, AccountingWeb.co.uk, 24 February 2012
93 “Thousands of civil servants face tax avoidance probe”, Financial Times, 3 May 2012
94 “Sweetman : More shocks on civil servant contractors”, AccountingWeb.co.uk, 3 May 2012
make the IR35 legislation easier to understand for those who are genuinely in business. This will include:

- strengthening up specialist compliance teams to tackle avoidance of employment income;
- simplifying the way IR35 is administered; and
- subject to consultation, requiring office holders/controlling persons who are integral to the running of an organisation to have PAYE and NICs deducted at source by the organisation by which they are engaged. (Finance Bill 2013).95

The consultation was launched on 23 May, when the Chief Secretary gave details to the House of the Treasury’s review of these ‘off payroll’ appointments. In his statement Mr Alexander confirmed that over 2,400 appointments had been found – though over 40% of these related to IT specialists:

The review looked at the extent of off-payroll engagements in Government Departments and their arm’s length bodies. With respect to the NHS, the review was limited to the boards of NHS organisations. None the less, the “Managing Public Money” guidance, and the new principles that I will set out today, apply in full to the NHS. The review could not include either local government or the BBC, which are not under direct control from central Government … nor does it include devolved Administrations …

Let me be clear to the House: the review published today did not seek to identify evidence of tax avoidance—that is the role of Her Majesty’s Revenue and Customs … Let me also make it clear there are circumstances where it may be necessary and appropriate for an employer to appoint an individual off payroll—for instance, where Departments need to employ specialists to carry out short-term roles when there is no available civil service expertise. That practice will continue. However … I can tell the House that the review has identified more than 2,400 off-payroll engagements in central Government Departments and their arm’s length bodies that were live on 31 January this year …

That lack of transparency cannot continue, so today each Department involved is publishing on its website a list of off-payroll appointees who, as of 31 January, were engaged at an annual cost to the Department of more than £58,200. The majority of cases relate to technical specialists; in fact, more than 40% relate specifically to IT specialists. The data also show that 70% of cases relate to arm’s length bodies. About 10% of the cases relate to payments made directly to a personal services company. More than 85% relate to intermediaries such as employment agencies, where it is not possible to know whether the individual is or is not using a personal service company. The other 5% relate to the self-employed, who are therefore subject to self-assessment in the normal way …

95 HC 1853 March 2012 para 2.207. The announcement was the subject of some press comment: for example, “Treasury pledges review of contractor salary loophole”, Financial Times, 23 March 2012 & “Crackdown on top earners who pay their dues via alternative channel”, Times, 24 March 2012.
About 900 of the cases—approximately 40%—date back longer than two years. In fact, more than 20 cases date back more than 10 years, which some might consider an astonishing length of time to be on a contract. It is also worth noting that since January this year, more than 350 off-payroll contracts identified by this review have since ended. In about 10% of those cases the individual remained with the Department but is now on the payroll.96

Mr Alexander announced a number of changes to departmental practice when ‘off payroll appointments’ were agreed:

Today I can announce new tighter rules on off-payroll appointments. First, the presumption is that in the future the most senior staff must be put on the payroll. Secondly, all Departments must put in place provisions that allow them to seek formal assurance that anyone paid a senior rate and employed off-payroll for more than six months is meeting their income tax and national insurance obligations in full. If that reassurance is not provided when requested, Departments should terminate the contract.

Finally, these new tighter rules will be monitored carefully and any Department that does not comply will be fined up to five times the cost of the salary by the Treasury. In addition to those changes, we have shared all the detailed information from the review with HMRC, which will be able to take any further action it decides is necessary in individual cases. There will be no lengthy transition period for the new rules, either. They will be implemented by September this year and will be applied to existing contracts too, subject to value for money. Departments will report to Parliament on the outcome as part of the 2012-13 annual report and accounts process.97

The Minister went on to give details of HMRC’s consultation on changing the application of IR35 to individuals given a ‘controlling’ function in the client’s organisation:

When IR35 was introduced 10 years ago, it was comparatively rare for controlling persons of an organisation to work through a personal service company. In the past few years, however, there have been high-profile reports of that happening, so today the Government are also consulting on the Budget proposal that all so-called “controlling persons” must by law be on the payroll of their organisation. This proposed tightening of the rules will apply to any organisation, be it public or private. It is right that when an individual is in a position to control the major activities of an organisation, they should be on the payroll of that organisation.98

In response many Members focused on the incidence of these arrangements, though, speaking for the Opposition, Rachel Reeves concurred that this aspect to IR35 “clearly needs to be addressed.”99

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96 HC Deb 23 May 2012 cc1159-60
97 HC Deb 23 May 2012 c1160. In answer to a subsequent PQ, the Minister stated the Treasury would monitor departmental implementation of these new arrangements, “and report back to me after one year” (HC Deb 17 July 2012 c676W).
98 HC Deb 23 May 2012 c1161
99 HC Deb 23 May 2012 c1163. On this occasion Bernard Jenkin MP raised concerns that the new test for a ‘controlling person’ could hit “musicians, artists and other who are traditionally regarded as self-employed” — a point the Minister thought that the consultation would address (op.cit. cc1165-6).
The consultation paper gave more details on the Government’s rationale:

The IR35 legislation places the obligation on the PSC to operate income tax and National Insurance in the relevant circumstances. This means that even where the appropriate tax and National Insurance for the circumstances of the case is being paid, that is not going to be clear and transparent to the engaging organisation. There is no reason it should be as the contract for the work has been made between the engaging organisation and the PSC under normal commercial practices.

The Government believes that, because of their role in an organisation, controlling persons should be required to meet their income tax and National Insurance obligations in a way which is transparent to their engager. This is not currently possible where they work through a PSC.

The Government has concluded that the most effective way to achieve the right level of transparency is for the engager to deduct income tax and National Insurance at source for payments they make to controlling persons in the same way as they do for their other employees and not to make payments direct to any PSC those controlling persons may work through for any other purposes. This requirement will provide the necessary assurances to the engaging organisation in a transparent way. It will also reduce the loss of the relevant tax and National Insurance to the Exchequer.  

It went on to give some details of how it would work in practice and what its remit would be:

This provision would place the responsibility of deducting the tax and National insurance payments on the engaging organisation as well as making them liable for the relevant employer’s National Insurance contributions. The IR35 legislation places this responsibility on the PSC. Placing the responsibility back onto the engaging organisation in the case of controlling persons removes some of the incentive for engaging organisations to encourage workers to be engaged through personal service companies as they will no longer make the National Insurance savings …

The Government proposes that a controlling person is defined as someone who is able to shape the direction of the organisation having authority or responsibility for directing or controlling the major activities of the engaging organisation during the year. This would be someone who has managerial control over a significant proportion of the organisation’s employees and/or control over a significant proportion of the budget of the organisation.

It was intended that micro businesses would not have to apply the new rules:

We want to exclude ‘micro businesses’ who engage controlling persons through a PSC from this provision. A micro business, is defined by the EU as a business which employs fewer than 10 persons and whose turnover and or balance sheet does not exceed €2million (approximately £1.7million.) This is because the

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100 Consultation into the Taxation of Controlling Persons, 23 May 2012 para 2.20-2
101 op. cit. para 3.5, 4.1
burden on these micro businesses would be disproportionate and we would not want to discourage enterprise.\(^\text{102}\)

The consultation document did not give any figures for the potential Exchequer impact of these changes, simply noting that further details would be published “in due course.” Responses were invited by 16 August 2012.

However, in December 2012 the Government announced it would not proceed with proposal. In a summary of the responses it had received, HM Revenue & Customs explained that there were considerable concerns that this would be a disproportionate response which would pose a serious risk to genuine commercial arrangements:

- There were considerable concerns about the administrative burden new and potentially complex rules could place on businesses; including smaller businesses and organisations who could struggle with its application.

- It was felt that the tax status of a worker engaged through an intermediary was not the concern of the client. While public sector arrangements must be open, the private sector is a different environment where such transparency is not critical. Notably feedback from trade bodies suggested that if an organisation felt they needed assurances from persons engaged through a PSC that the arrangement was not abusive, then the worker would be prepared to offer up evidence to satisfy concerns. One respondent said: ‘in the private sector it is already common practice for commercial agreements between end-user clients and recruitment firms to place strict obligations and indemnities upon the recruitment firm to ensure the payment by the PSC/individual of all appropriate taxes and national insurance’.\(^\text{103}\)

In addition there had been a consensus among respondents that the existing rules were sufficient to prevent the exploitation of these arrangements to avoid tax:

- Respondents were broadly in agreement that the correct application of IR35 should prevent the overwhelming majority of instances in which a PSC is being used to avoid tax and National Insurance. It was suggested that educating businesses about the difference between a short term, high impact appointment and deemed employment could eliminate some misapplication of the current rules. One respondent said: ‘The first alternative would be to enforce the IR35 legislation more effectively. The rules of IR35 introduced in April 2000 were implemented to deal with precisely this problem.’

- Many respondents felt that the tax affairs of an individual were not the concern of the client, but if an organisation wanted to avoid questions over an arrangement they could decide to put all senior appointees on the payroll or ask to see an accountant’s certificate.\(^\text{104}\)

As a consequence the Government concluded that the changes to policing IR35, announced in Budget 2012, along with the changes announced in May to recruitment practices in the public sector, would

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\(^{102}\) op.cit. para 4.2

\(^{103}\) The Taxation of Controlling Persons: Summary of Responses, 11 December 2012 p5

\(^{104}\) op.cit. p6
be sufficient to prevent tax avoidance through disguised employment. Provision would be made in Finance Bill 2013 to “strengthen the existing intermediaries’ legislation (IR35) to put beyond doubt that it applies to office holders for tax purposes.” The decision appears to have been welcomed; John Whiting at the Chartered Institute of Taxation said that it was a “practical and proportionate way forward”, because provisions requiring deduction of tax at source “would have added unnecessary complexity to the tax system and would have added to administrative burdens in the private sector who were not the causes of the problem.”

Following this, the Government published most of the Finance Bill 2013 in draft; this included this small change to the IR35 rules. As noted above, the intermediaries legislation is consolidated in the Income Tax (Earnings & Pensions) Act (ITEPA) 2003: specifically, chapter 8 to part 2 of the Act. Section 49(1) specifies those engagements covered by IR35:

(a) an individual (“the worker”) personally performs, or is under an obligation personally to perform, services for the purposes of a business carried on by another person (“the client”),

(b) the services are provided not under a contract directly between the client and the worker but under arrangements involving a third party (“the intermediary”), and

(c) the circumstances are such that, if the services were provided under a contract directly between the client and the worker, the worker would be regarded for income tax purposes as an employee of the client.

It was proposed to amend the wording of this section to make it clear that the rules apply to office holders; s49(1)(c) would read as follows:

“(c) the circumstances are such that—

(i) if the services were provided under a contract directly between the client and the worker, the worker would be regarded for income tax purposes as an employee of the client or the holder of an office under the client, or

(ii) the worker is an office-holder who holds that office under the client and the services relate to the office.”

The 2013 Budget confirmed this change would go ahead. Provision to this effect is made in s22 FA 2013.

As noted, the Treasury's review of the use of PSCs had not extended to the BBC. In July 2012 Public Accounts Committee took evidence from a number of witnesses on the use of PSCs in the public sector – and this

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105 op.cit. p4.
106 CIOT press notice, Controlling persons – Government praised for practical approach, 5 December 2012
107 HC Deb 11 December 2012 cc15-16WS
108 HMT/HMRC, Draft clauses and explanatory notes for Finance Bill 2013, December 2012 p192. The notes to the draft clause explain that the corresponding provisions regarding NICs (ie, reg 6 of SI 2000/727) already make it clear that the rules extend to office holders engaged through a third party (pp193-4).
109 HC 1033, March 2013 para 2.192. See also, HMRC, Change to IR35 legislation to cover office-holders from 6 April 2013, 26 March 2013.
110 This was the subject of a short debate in Committee: Public Bill Committee (Finance Bill), Eighth sitting, 21 May 2013 cc 223-232.
also included officials from the BBC. As the Committee noted in a report, published in October, the BBC gave a commitment to consider if its arrangements were appropriate:111

The BBC has identified 25,000 off-payroll contracts, including 13,000 contracts for ‘talent’, but cannot provide any assurance that these individuals are paying the correct amount of tax. The BBC told us that the use of freelance workers is a key part of their business model. However, the BBC accepted that many of its contracts with presenters who are paid through personal service companies could share the same features as typical PAYE employment contracts. Although the BBC told us it provides information on its off-payroll arrangements to HM Revenue & Customs, it has no means of ensuring that its freelancers are paying the right amount of tax.

The BBC told us that it would be carrying out a detailed review of its off-payroll arrangements. The BBC’s review should specifically consider whether the contracts resemble typical employment contracts, their duration and the number of repeat contracts, and the salaries involved. The review should set out how it will gain assurance that its staff pay the right level of income tax and national insurance on their income.

The BBC’s review was completed in November that year; in this it announced that it would change its approach to taking on freelancers: specifically –

We no longer intend to adopt our previous position of engaging on air talent with long-term contracts through service companies. Instead, we will:-

- Introduce a more objective and specific employment test to ensure that if an individual clearly displays the characteristics of an employee, they will be engaged as staff with tax and NIC deducted at source rather than through a service company.

- Work with HMRC to develop objective and consistent criteria for the tax treatment of on air talent to give us the confidence to engage these individuals directly as sole traders where they meet the criteria without the risk of misclassification set out above.112

In turn the Committee welcomed the outcome of this review:

We welcome the action taken by the BBC to address our previous findings on its off-payroll arrangements. The BBC commissioned a review of its arrangements in response to our concerns and is planning to review all 6,123 contracts that it has with personal service companies. The BBC Trust should monitor progress in completing these reviews and the BBC’s use of personal service companies, and inform this Committee of any issues that it identifies.113

111 HM Treasury’s review of the taxation arrangements of public sector employees, HC 532 2012-13, 5 October 2012 pp4-5
112 BBC, Review of Freelance Engagement Model, 7 November 2012 p3
113 British Broadcasting Corporation: Off-payroll contracting and severance package for the Director General, HC 774 of 2012-13, 20 December 2012 p5
Subsequently the corporation gave some details of the impact of this approach on the number of freelancers it would have on its books.\textsuperscript{114}

In March 2014 the then Chief Secretary, Danny Alexander, published the Treasury’s first review of departments’ compliance with the new rules for off-payroll engagements; full details were given in a written Ministerial statement.\textsuperscript{115} Mr Alexander announced this review at Treasury Questions the same day, noting that “compliance with those rules has been high, but details have been passed to Her Majesty’s Revenue and Customs in 125 cases where appropriate assurances have not been received, and I have imposed financial sanctions on two Departments that have breached the rules.”\textsuperscript{116}

In their report the Lords Select Committee on Personal Service Companies touched on this issue, suggesting that, “the Government’s guidance on off-payroll engagements in the public sector [is] being implemented inconsistently across departments, and that the full extent of these engagements within Government [is] not yet known”:

The Treasury Review of off-payroll appointments provided only a limited assessment of the extent of such engagements; large areas of public service provision, such as local government and some health services, were not included in its scope. We recommend that the Government carry out an assessment of the extent to which off-payroll engagements are used elsewhere in the public sector, including by those earning less than £58,200 per annum …

[The Treasury’s new rules] were formalised in Procurement Policy Note (PPN) 07/12, published by the Cabinet Office in August 2012. The PPN sets out illustrative contract clauses which allow assurances about tax arrangements to be sought; these were to be inserted into all new contracts (and contract renewals) from August 2012 … [As this guidance] currently appears to be applied inconsistently across departments, we recommend that Her Majesty’s Treasury take a leading role in ensuring consistency of application and that it should go to greater lengths to monitor the implementation of [the PPN] across Government departments.\textsuperscript{117}

The Government did not accept either of these recommendations. On the scope of its review, it noted that this “went further in requiring that departments should determine whether it was appropriate to seek assurance from individuals earning less than £220 per day or who had been engaged for less than six months.” On the question of the Treasury taking a ‘leading role’, the Government said:

Cabinet Office and HM Treasury have published guidance on the assurance process and required departments to detail their implementation of these recommendations in their end of year accounts. HM Treasury released a review of compliance with these recommendations in March 2014.

By reporting this information in departments’ end of year accounts, it is clear that Accounting Officers, in accordance with their wider responsibility for managing public money, are

\textsuperscript{114} See, “BBC to test freelance staff over tax”, \textit{BBC News}, 7 November 2013
\textsuperscript{115} HC Deb 11 March 2014 cc9-13WS
\textsuperscript{116} HC Deb 11 March 2014 c172
\textsuperscript{117} Personal service companies, HL Paper 160 of 2013-14, 7 April 2014 p50, p46, p53
responsible for ensuring that the information is correct and that the risk of tax avoidance by off payroll workers that they have engaged is minimised. Departments are able to seek guidance from HMRC and HM Treasury as required.118

A second review of off-payroll appointments was completed by HM Treasury in March 2015. This found that 95% of departments were “broadly compliant”, though the Ministry of Defence and the Department of Health were fined for two breaches of the rules.119 Over the year government departments had sought assurances from 2,505 contractors that their tax affairs were in order. In 257 cases, “contracts were terminated or came to an end before assurance was received.”120

Subsequently in his 2016 Budget speech the then Chancellor George Osborne set out a number of measures to reduce tax avoidance & evasion, and as part of this he announced that, “public sector organisations will have a new duty to ensure that those working for them pay the correct tax rather than giving a tax advantage to those who choose to contract their work through personal service companies.”121 Following a consultation exercise, the Government introduced legislation to implement this reform from April 2017.122 This reform is discussed in more detail in section 6 of this paper. In July 2019 Treasury Minister Elizabeth Truss announced that in the light of these changes the 2012 rules were no longer necessary, and that the Treasury would provide updated guidance for government departments.123

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118 Personal service companies: the Government’s response, Cm 8878, 9 June 2014 pp11-12.
119 HM Treasury press notice, Second evaluation of tax arrangements for off-payroll contracts in the public sector published, 5 March 2015
120 HC Deb 5 March 2015 cc66-70W5
121 HC Deb 16 March 2016 c956
122 Provision to this effect is included in the Finance Act 2017 (section 6 & Schedule 1).
123 Written Statement HCWS1774, 22 July 2019
5. Further developments
(2013-15)

5.1 Offshore intermediaries (Budget 2013)

In the 2013 Budget the Coalition Government announced that it would consult on proposals to tackle tax avoidance by intermediary companies, based offshore, who provided labour services to UK companies. A review of these arrangements had found that at least 100,000 individuals were employed through an intermediary company that had no presence, residence or place of business in the UK. In many cases employees were unaware that their payroll was located offshore and tax was being avoided on their earnings. Subsequently HMRC estimated that “at least £100m” was not being remitted.

A consultation paper on the detail of these changes was published on 30 May 2013. In this the Government identified two difficulties in ensuring that the correct amounts of tax were being paid in these circumstances. First, complex structures involving several intermediaries in a chain of arrangements between the employer and the end client meant HMRC might be unable to pinpoint who the end user actually was. Second, offshore employers were able to exploit the different tests, set out in tax and NICs legislation, for determining liability:

**Tax Legislation**

Section 689 of the *Income Tax (Earnings and Pensions) Act (ITEPA) 2003* applies where there is an offshore employer who is supplying workers who are working in the UK for a UK business. Under this legislation the UK business will be responsible for making deductions of income tax and remitting this to HMRC through the Pay As You Earn (PAYE) system, where the offshore employer has not already made these payments.

Although the legislation places responsibility onto the UK business, that business is often unaware that the employee is being paid by an offshore employer. It is also difficult for HMRC to establish that the employee is being paid by an offshore employer and so compel the UK business to operate PAYE.

If there is no UK place of business then, under Section 7 *Taxes Management Act (TMA) 1970* the worker will be responsible for making a return through self assessment to account for their income tax. However, the worker is often unaware of the arrangements that are in place or that there is a requirement on them to make a return.

**National Insurance Legislation**

Paragraph 9 of Schedule 3 to the *Social Security (Categorisation of Earners) Regulations 1978* (SI 1978/1689), known as the “host regulations”, may apply where there is an offshore employer but the worker is working in the UK for a UK company … [The

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124 The review was launched four months before: *Autumn Statement*, Cm 8480, December 2012 para 2.104
125 HC Deb 18 March 2013 c34WS
126 *Offshore employer intermediaries – summary of responses*, October 2013 para 3.15
regulations place] the requirement to pay employer and deduct employee NICs on the UK end user of the labour/end client where the worker provides their personal service. Offshore employers will often claim that there is no requirement for personal service of the worker, or that they are supplying a composite service, so the host regulations do not apply …

As with PAYE the UK end client may not know that the worker is supplied by an offshore employer and HMRC has difficulty in identifying such cases.\textsuperscript{128}

Although offshore employers might decide to make \textit{voluntary} payments of income tax and employee NICs for the workers they supply, HMRC had “little power to check that these are correct or to ensure that they are made on time.”\textsuperscript{129}

To tackle this problem the Government proposed a new two-part test: in the first instance, the offshore employer would be responsible for accounting for tax and NICs. Should the offshore employer default on these obligations, the responsibility would pass to the business that contracted directly with the end client – ‘Intermediary 1’ as shown in the diagram below:

If the worker’s services were provided by an offshore employer \textit{without} any intermediary, the obligations to pay tax and NICs would pass to the end client.

To help HMRC’s enforcement of these rules, intermediaries would be required to hold information about the way in which workers they placed were paid and engaged, and to make quarterly returns of this information.\textsuperscript{130}

\textsuperscript{128} \textit{op.cit.} pp10-11. Further to the host regulations, there are also reciprocal social security arrangements which apply to employers based in other European countries (\textit{op.cit.p11})

\textsuperscript{129} \textit{op.cit.p9}

\textsuperscript{130} Provisions to this effect were published, as clauses 3-5 to the draft \textit{National Insurance Contributions Bill}, \textit{published in July 2013}. 
In October 2013 the Government published a revised approach, in the light of the responses it had had.\textsuperscript{131} A majority of respondents had raised three concerns about this two-part test:

- Offshore employers might willingly default on their obligations, knowing these would pass to the relevant intermediary or the end user. Other intermediaries in a supply chain would have no incentive to reveal the true nature of a worker’s engagement, because they would never be liable for any debts.
- The requirements placed on businesses in the supply chain to keep records and submit returns would be onerous, especially where these arrangements were complex.
- The proposals would add complexity to the existing law.

As an alternative approach the Government proposed that in these circumstances ‘Intermediary 1’ would be wholly and immediately responsible for accounting for the tax and NICs of all workers ultimately engaged by an offshore business:

The Government has evaluated the role of employment businesses and agencies, and concluded that it is reasonable to expect employment businesses and agencies to undertake due diligence.

Their role is supplying temporary labour to businesses and the Government believes that it is reasonable for the end client to expect that the appropriate amount of tax and NICs has been paid in respect of those workers. This is why obligations will fall immediately and wholly to Intermediary 1, and in the case of a default, will not be passed on to the end user.

Where there are no onshore intermediaries, in a similar way to the existing legislation, the end user of the labour will be liable for the accounting and payment of employment taxes. Intermediary 1, or in certain cases the end user, will be responsible for making returns in respect of these obligations through Real Time Information (RTI).

This new approach is illustrated below: \textsuperscript{132}

The consultation document had also asked about the implications of its proposals for the oil and gas sector, where very many individuals will be

\textsuperscript{131} Offshore employer intermediaries – summary of responses, October 2013
Personal service companies & IR35

working offshore. Respondents raised two particular concerns: first, that the use of ‘Joint Operating Agreements’ to govern the organisation of oilfields made it very difficult to apply this model – in particular, distinguishing between an end user of the labour, and Intermediary. The second concern was that the contractual chains in the oil and gas sector were highly complex, with hundreds of contracts and sub-contracts used in a single installation. As an alternative, the Government proposed specific legislation for this sector.

Legislation to make this series of changes was split three ways: first, the Finance Act 2014 made the necessary changes to income tax, and brought in the new requirements for record-keeping and returns; second, changes to NICs were made by secondary legislation; third, the certification scheme for the oil and gas sector was introduced by the National Insurance Contributions Act 2014.

In the latter case, the main purpose of this legislation was to introduce a new ‘Employment Allowance’ – a £2,000 cut in employer NICs for all businesses and charities, from April 2014. When the Bill was published in October 2013 the Government published an updated impact assessment; this put the Exchequer saving from these changes as a whole at £80-£90m a year.

5.2 Disguised self-employment (Budget 2014)

In December 2013 the Coalition Government published a second consultation, on proposals to prevent employment agencies being able to label workers as self-employed, by means of contrived contractual terms, so as to avoid tax and NICs.

In the past this has been a problem in the construction industry but the evidence is that the practice has become more widespread:

The use of intermediaries to facilitate false self-employment started in the construction industry as a way to reduce the risk to engagers of incorrectly engaging workers on a self-employed basis. However, this type of avoidance facilitated through intermediaries is now widespread in a number of other sectors including driving, catering and the security industry. In those other sectors, there is evidence of existing permanent employees being...
taken out of direct employment and being moved into false self-employment arrangements involving intermediaries. These intermediaries often require the worker to pay a fee of between £10 and £25 per week, further reducing any benefit to the worker of these arrangements.

There are a number of ways which intermediaries are exploiting the legislation to facilitate the avoidance of employment taxes. Sometimes the worker is simply labelled as self-employed. In other cases the intermediary will set up the contract with the worker so it allows that the worker could send someone else to do their job. In reality this could not, and does not, happen. 141

The consultation document summarised the way that agencies have to account for tax and NICs in relation to payments made to a worker they have placed with a client, if the worker meets certain criteria – principally, that they provide their services personally:

The existing legislation in this area comprises separate legislation which applies to Income Tax and NICs ...

**Income Tax Legislation**

The income tax legislation is contained at sections 44-47 of the *Income Tax (Earnings & Pensions) Act (ITEPA) 2003* [the ‘Agency legislation’]. For the legislation to apply to a person’s engagement, four conditions (under s44(1) (a) –(d) of the legislation) all must be met:

(a) The worker personally provides, or is under an obligation personally to provide, services to another person. This is where an intermediary supplies a worker to an end client;

(b) The services are supplied by or through an intermediary or third party under the terms of an agency contract;

(c) The worker is subject to (or to the right of) supervision, direction or control as to the manner in which the services are provided; and

(d) Any payments are not already taxed as employment income.

The worker must be providing their services under the terms of an agency contract. The legislation defines an agency contract as being: “A contract made between the worker and the agency under the terms of which the worker is obliged to personally provide services to the client.”

Where the above conditions are met, the payment received by the worker is treated as being in consequence of an employment between the intermediary (agency) and worker. This means that the intermediary (agency) must deduct Income Tax at source from the worker. Similar provisions apply for National Insurance.

**National Insurance Legislation**

The relevant National Insurance legislation is contained within The Social Security (Categorisation of Earners) Regulations 1978:

- Schedule 1, Column (A) paragraph 2 and Column (B) paragraph 2; and
- Schedule 3 Column (A) paragraph 2 and Column (B) paragraph 2.

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and the Northern Ireland equivalent (The Social Security (Categorisation of Earners) (Northern Ireland) Regulations 1978).

These Regulations dictate that a person (the worker) will be treated as being an “employed earner” for the purpose of NICs when they meet the conditions in the Regulations. When someone is an employed earner for NICs then employer NICs is payable by the employer (or deemed employer for NICs purposes i.e. the intermediary) and the worker has to pay Class 1 employee NICs rather than Class 2 and Class 4 NICs that apply to the self-employed.

The tests in the NICs legislation are very similar to those in the tax legislation. They require the worker to be subject to, or the right of, direction, supervision or control and that the worker provides their services personally.142

Many intermediaries avoiding tax and NICs were doing so by exploiting the test that agency workers should provide their services personally.

[These intermediaries] … attempt to sidestep this test by claiming that there is no obligation for the worker to provide their services personally. This may be done by including a clause in the contract that states the worker is able to send someone else to do their work. In fact this is often not the case because in reality the engager wants that specific worker. There is often collusion between the parties, as they all benefit from presenting the worker as being self-employed. In such cases it can be difficult for HMRC to prove that the reality of the situation is different from that presented in the contracts.143

The consultation document set out three scenarios that intermediaries have used to disguise the worker’s employment status:

In the first scenario the employer of the worker moves a number of their existing employees from being employed directly to engaging them through an intermediary on a self-employed basis. The duties that the workers undertake remain the same; it is only the employment status of the worker that changes.

In the second scenario a new worker may agree terms with the engager including pay but the engager then stipulates the worker must be paid by a specific employment intermediary or they will not be engaged.

A third scenario involves the supply of temporary labour to an end client by an Employment Business. The Employment Business sources the labour, (possibly via other intermediaries) but will give the worker no choice other than to be self-employed. This happens even where the worker is clearly under the control of the end user and has to perform the work personally.

In these cases workers often lose their employment rights because they are not classified as an employee, and receive little or no financial reward for doing so:

In all of these scenarios the worker may be unaware that they are engaged on a self-employed basis and may only discover they are not employed when they attempt to claim holiday pay, sick pay or redundancy pay. In such circumstances the worker will not register with HMRC as self-employed and may have a large

143  op.cit. p10
unexpected tax bill at the end of the year. In other cases the worker is aware that they are being engaged as self-employed and are incentivised to do so for a small increase in pay. This rarely makes up for the important benefits that the worker has given up. On other occasions the worker is given little choice but to accept the engagement terms as this is the only way they are able to find work.

The worker is usually charged a fee by the intermediary of between £10 and £25 per week. This is charged even where the worker is only working for one day a week; meaning the worker takes home very little for their day’s work. HMRC have seen examples where workers have mistaken the fee to the intermediary for a deduction at source for tax.

The engager and employment intermediary often share between them the employer NICs and employment rights savings, with the worker receiving very little, if any, financial benefits from these arrangements.  

As a solution the Government proposed that the personal service test should be removed, and the legislation focus on “whether the worker is subject to, or the right of, supervision, direction or control as to the manner in which the duties are carried out.” For these purposes, control would mean “that anyone is able to exercise control, or have the right to exercise control about how the work is carried out”

Other factors will also be considered such as the worker being able to decide when to carry out the work or where but these on their own will not be sufficient to bring someone within the legislation. So if a worker has to carry out their work between certain hours because, for example, this is the only time that the site is open, and has to carry out the work on site but can decide how to do their work and beyond complying with the specification there is no checking of the work then they would be outside of the legislation. However, if someone is able to supervise and could ask for the work to be done in a different way or different work to be done then the worker would be within the legislation.

The onus for proving that someone did not meet this control test – and was, in fact, self-employed – would lie with the intermediary. As with the Agency legislation, the Government did not anticipate the new rules applying to PSCs – as those supplying services through a PSC would not, generally, meet all of the relevant criteria. Draft legislation and guidance were included in the consultation document, and the Government proposed the new rules would take effect from 6 April 2014.

The Government confirmed it would proceed with these proposals in the 2014 Budget; these changes were forecast to raise £445m in 2014/15, falling to £425m in 2015/16. Legislation to give effect to these proposals was included in the Finance Bill 2014, with certain amendments in the light of the responses received. Two principal concerns were raised by respondents: that the legislation was being

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145 op.cit. p15
146 op.cit. para 4.4, para 4.8, Annex C
147 *Budget 2014*, HC 1104, March 2014 p58 (Table 2.2 – item s).
introduced too quickly, and that the control test would be difficult to operate in practice. The Government resisted any delay in the implementation date, but acknowledged concerns about situations when intermediaries are actively misled by a business as to whether a worker meets the control test or not:

Almost half of stakeholders raised concerns both over the shorter consultation period and that the legislation was being introduced too quickly, suggesting that the measure should take effect from April 2015 instead. Having considered these arguments the Government believes delaying implementation would provide the opportunity for new avoidance arrangements to be put in place and therefore implementation will not be delayed …

The majority of respondents thought the control test would be difficult to operate in practice. Some accountancy firms, accountancy bodies and recruitment representative bodies were concerned about a company’s ability to prove a negative i.e. that there is no control over the worker. In response to these issues HMRC is developing extensive guidance to illustrate the control test.

Stakeholders were particularly concerned that they may be provided with fraudulent documents purporting either no control or right of control or that the worker had had income tax and NICs deducted through PAYE by a business further down the contractual chain. The Government recognises the concerns which have been raised about the level of due diligence required in order to try and ascertain supervision, direction or control. The Government has therefore amended its proposal such that where the company has been provided with fraudulent documents PAYE liability will sit with the body providing these documents.148

The response document gives an illustration of how this would work in practice:149

There were also concerns as to how precisely the legislation interacted with the IR35 rules. The Government reiterated that it was not the policy intention to change the way the two sets of rules interacted:

In most cases the agency legislation has never applied, and will continue not to apply, to PSCs because the agency legislation does not apply where:

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149 Onshore Employment Intermediaries, 13 March 2014 p15
The remuneration is already taxed as employment income because of other provisions in the Taxes Acts, or
The remuneration is not in consequence of the worker providing their services under the contract
This means that where a worker withdraws profits from their limited company as salary (employment income), the agency legislation would not apply because income tax and NICs will already have been deducted. It will also not apply in most cases where profits are withdrawn as dividends as this is a return on capital distribution, not remuneration in consequence of the worker providing their services.150

Given those concerns, HMRC published a technical note to clarify their approach.151

Following the publication of the Bill, the Treasury Minister David Gauke announced that both the income tax provisions – in the Bill – and their NICs counterpart – in secondary legislation – would be supported by a targeted anti-avoidance rule, or ‘TAAR’:

We have introduced legislation which amends the agency legislation in the Social Security (Categorisation of Earners) Regulations 1978 (“the 1978 regulations”) to tackle avoidance, through false self-employment facilitated by intermediaries, of national insurance contributions (“NICs”). We have also introduced legislation, in the Finance Bill 2014, to tackle the same problem in relation to income tax. The amendments to the 1978 regulations will come into force on 6 April 2014, as will the legislation relating to income tax (Budget Resolution No. 11, recorded in the Votes and Proceedings of the House of Commons for 25 March 2014).

The income tax legislation is supported by a targeted anti-avoidance rule (“TAAR”) which is intended to ensure that those workers who would be employees, but for the imposition of artificially constructed intermediary arrangements, are treated as employees for the purposes of tax.

I am today announcing that we intend to introduce a TAAR for NICs, with retrospective effect to 6 April 2014, at the next available legislative opportunity. This will support the 1978 regulations and ensure that those workers who would be employed earners but for the imposition of artificially constructed intermediary arrangements are also treated as employed earners for the purposes of NICs.

The TAAR for NICs will follow the TAAR for income tax, details of which can be found at clause 6, section 46A of the Finance Bill 2014 which was introduced into the House of Commons on 27 March 2014.152

150 Onshore Employment Intermediaries, 13 March 2014 para 3.55-6
151 HMRC, Interaction of PSC’s with the proposed changes to Chapter 7 S44-47 ITEPA 2003, March 2014.
152 HC Deb 3 April 2014 cc89-90WS. A TAAR is used to frustrate avoidance schemes exploiting a specific area of the tax code by allowing the court to consider the purpose of a scheme, rather than being restricted to assess whether the scheme delivers the promised tax saving according to the strict letter of the law (see, Institute for Fiscal Studies, Countering tax avoidance in the UK, February 2009 pp25-28).
This option had been raised in the consultation, and in its response document the Government gave more details as to why it had decided to introduce this rule:

The Government is aware that certain elements in the temporary labour market are quick to react to any legislative changes and to find new vehicles to reduce their income tax and NICs. The Government therefore intend to introduce a TAAR in the legislation to deter such avoidance. It is designed to enable HMRC to consider both

i) the motive for setting up the arrangements – whether it is set up with the motive of avoiding income tax, and

ii) what it achieves – whether it results in less income tax being paid.

This means that people who set up PSCs for a reason other than reducing tax – such as the limited liability protections incorporation provides – would not be within the TAAR. However, HMRC would be able to use the TAAR in the most egregious cases where, for instance, an agency requires all of their workers to set up a PSC to avoid the new legislation. HMRC will continue to monitor activity in these areas.153

The provisions in the Finance Bill to make these changes were debated, and agreed, without amendment, on 1 May 2014.154

Speaking for the Opposition on this occasion Cathy Jamieson, said that “in general terms, we are pleased that the Government are introducing these measures” but raised concerns as to whether HMRC had sufficient resources to monitor and police the new arrangements, particularly in relation to bogus self-employment.155 In response the Minister, Mr Gauke, gave an overview of these clauses:

The avoidance [targeted by these provisions] … takes two forms: falsely presenting employees as self-employed, and placing the employer or employment business of the UK worker outside the UK. Both those models rely on standardised substitution clauses within contracts in an attempt to avoid existing agency legislation, and clause 16 strengthens the existing agency rules to stop that.

The clause also introduces a targeted anti-avoidance rule to prevent people from setting up even more convoluted arrangements in an attempt to avoid the changes. We recognise that there may be times when fraudulent documents are provided to employment intermediaries. Such documents might claim that the worker is either already having pay-as-you-earn deducted, or is not subject to supervision, direction or control. To deal with that possibility, we have included a provision that deems the person who provided the fraudulent documents to be the employer for tax purposes.

Clauses 17, 18 and 20 support clause 16. Clause 17 allows HMRC to transfer a company’s outstanding pay-as-you-earn debts to directors where HMRC has used the targeted anti-avoidance rule or the provision relating to fraudulent documents. Clause 18

154 Public Bill Committee (Finance Bill), Fourth Sitting, 1 May 2014 cc112-128. The Committee went on to briefly debate, and agree, to clause 21, which provides for the separate scheme for oil & gas workers, discussed above (op.cit. cc128-131).
155 op.cit. c113, cc115-6
provides HMRC with the power to create legislation requiring employment intermediaries to keep records, to provide them to HMRC and to penalise the intermediaries if they fail to do so. The clause supports HMRC’s compliance work, ensuring that it is targeted where the risk is highest. Clause 20 clarifies that where a UK employment intermediary has placed workers who are being employed or engaged outside the UK, it is the UK employment intermediary that is responsible for administering pay-as-you- earn.156

The Minister underlined the fact that the “clauses will not generally affect internationally mobile workers who come to the UK for a period of time and also work in other countries”: That is because the employers of such workers do not generally attempt to manipulate the existing legislation. The provisions are designed to target employers of people who live in the UK, work in the UK and, more often than not, have always lived and worked in the UK. We have examples of employers of UK teachers in Jersey, of UK nurses in Guernsey and UK crop pickers in Singapore—that is clearly not right.157

Mr Gauke went on to address Ms Jamieson’s concerns as to the level of awareness across the industry of the new rules, and HMRC’s work to ensure compliance:

HMRC and the Treasury have met extensively with people in the industry and representative bodies. Guidance has been published to ensure that people know when and how the changes will apply.

As to whether this could affect the genuinely self-employed, while the absence of any obligation to provide a personal service has long been held as an indicator of self-employment, and it is also most unlikely for a person who is personally providing their services in a genuinely self-employed capacity to be under the supervision, direction or control of someone else, the inclusion of a standardised substitution clause within contracts has for too long been used as a way of avoiding being caught by the agency legislation … when someone is genuinely not under supervision, direction or control for the manner in which they undertake their duties, it is fine for them to be engaged on a self-employed basis…

In terms of monitoring compliance in the construction sector specifically, all subcontractor payments made are returned to HMRC under the construction industry scheme. That will enable a close monitoring of the extent of non-compliance.158

5.3 Tax relief for travel & subsistence expenses (Budget 2015)

In general, the costs that employees incur in travelling to work are not tax-deductible – because employees do not incur these costs in carrying out their duties. However, tax relief is available where, as part of their job, someone has to travel to a separate location – a ‘temporary workplace’. Some agencies take on workers under ‘overarching

156 op. cit. cc122-3
157 op. cit. c123
158 op. cit. c127
contracts of employment’ (OACs), where the worker has several work placements. The contract covers the worker’s placement with a series of final clients. The agency acts as the worker’s employer, though the worker never works on the agency’s premises – but only at each client’s location. Each of these locations is classified as a ‘temporary workplace’. The travel and subsistence costs that the worker incurs over the length of the contract are then set against their tax liability.

In July 2008 HMRC published a consultation paper, which discussed the practice of some employment agencies and so-called ‘umbrella companies’ offering temporary workers the means to claim travel expenses by means of an ‘overarching employment contract’. In some cases this had led to individual workers claiming for expenses they had not actually incurred, and HMRC finding it difficult to recover the tax and NICs that should have been paid. A short extract is reproduced below, to illustrate how these schemes work:

3.11 Most temporary workers on short-term contracts are not entitled to tax relief for travel expenses between home and work, since they will usually only work at one location during that employment. Travel from home to this location is not eligible for tax relief since it would be considered a permanent (not a temporary) workplace, and is not undertaken “in the performance of the duties” of that engagement.

3.12 Similarly, temporary workers working through an employment agency are not normally entitled to tax relief for travel between home and work. This is because although they may be contracted to work on different engagements through the same employment agency, each engagement is treated as a separate employment for tax purposes, and a temporary worker normally attends only one workplace for all or almost all of that engagement.

3.13 For the vast majority of temporary workers who are employed directly or through an agency, this means they are treated in the same way as permanent employees, who are also not entitled to tax relief for travel between home and work. However, use of an overarching employment contract allows temporary workers access to travel expenses, which would not normally be available to them.

3.14 An overarching employment contract works by linking a series of separate employments, or agency assignments, into a single, ongoing employment. This changes what would otherwise be a series of permanent workplaces (for which no tax relief is due for travel between home and work) into temporary workplaces (for which relief is due).

3.15 By using an overarching employment contract a worker can often claim tax relief on travel expenses between home and work provided the site he works at has now become a temporary workplace.

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159 Workers operating through an umbrella company are employees of that company, though they will be working for a series of end clients on a temporary basis. The clients pay the company, which in turn, pays its workers, deducting tax and NICs, as well as a fee for its services.

The paper went on to explain that often schemes would require the worker to give up part of their salary to be paid travel expenses as a tax-free allowance:

3.16 The use of overarching employment contracts often allows workers to arrange their affairs so that they are entitled to tax relief for travel expenses, but in most cases the travel expenses are not paid on top of the worker’s salary. Instead they are paid as part of a salary sacrifice arrangement. Salary sacrifice arrangements enable a worker to “sacrifice” a proportion of their salary, which is instead paid as travel expenses - free of income tax and NICs.

3.17 The worker benefits as he receives a proportion of his money free of the income tax and NICs which would otherwise have been due and in this way increases his take home pay. The worker’s employer also benefits since the amount of salary on which it has to pay employer’s NICs is reduced. In some cases the employer adjusts the rates it pays to take account of the lower income tax and NICs bill so the employee does not necessarily obtain the full advantage of the relief to which he is entitled.

3.18 Of course, depending on the labour market at the time, employers may pay some or all of the workers’ travel expenses on top of their salary, rather than under a salary sacrifice arrangement. If workers are in demand it is more likely that travel expenses will be paid on top of a worker’s salary rather than under a salary sacrifice.

Companies may obtain a ‘dispensation’ from HMRC when paying employees certain expenses and benefits, to do so without making a full and complete return of all these payments. There are obvious advantages to this arrangement in reducing bureaucracy and employer costs, but it comes with a compliance risk:

3.19 An umbrella company or an employment agency (like other employers) can obtain a dispensation from HM Revenue and Customs (HMRC) that includes an agreement to pay scale rate subsistence allowances to cover the cost of meals that employees buy when they are at a temporary workplace. Subsistence expenses count among travel expenses.

3.20 Often the employer will seek a dispensation for the payments it intends to make. Dispensations are issued in order to reduce administrative burdens on businesses and HMRC. A dispensation is an agreement between HMRC and the employer about what benefits and expenses can be paid to its employees, without them having to be notified to HMRC.

3.21 Any dispensation given to a business by HMRC will set out the circumstances and amounts that can be claimed for that expense without any associated payment being reported. Where the employer can demonstrate the amounts it pays its employees broadly reflect the amounts of allowable expenditure its employees incur, then HMRC will also agree scale rate allowances that can be included within the dispensation. If a dispensation includes such an agreement, this means that the umbrella company or employment agency can pay the worker’s travel and subsistence expenses, without having to report these expenses annually to HMRC on forms P11D.

3.22 Subsistence expenses, which count as travel expenses, are a common example of expenses which employers choose to
reimburse by means of a scale rate payment rather than by reimbursing the precise expenditure incurred. For example, instead of requiring a receipt to be kept, an employer may allow a standard amount of £6.50 for breakfast to be claimed.

3.23 HMRC’s guidance for staff says that when considering applications, they need to be satisfied that the proposed scale rate payments are set at a level which broadly represents the amount that the employees are actually spending on allowable subsistence expenses. However, in the case of the disparate workforces and working patterns covered by an umbrella company, it may be difficult to arrive at a sensible amount that genuinely represents actual expenditure incurred by employees. 161

Commenting on the extent of this problem, the paper noted that although there was “a degree of uncertainty” about the numbers, HMRC estimated that there were about 120 umbrella companies were using OACs, employing 100,000 temporary workers at any one time – and that it was thought the number of workers in these companies had “grown around 50 per cent over the previous year.” 162

At the time of the Pre-Budget Report in November 2008, the Labour Government stated it had, “decided to leave the current rules unchanged. However, in the light of evidence from the consultation confirming poor levels of compliance in this area HMRC will refocus its efforts to ensure that the current regime is properly applied. If compliance does not improve, the Government may return to this at a later date.” 163

In August 2009 HMRC issued a brief, giving some details of its activity in this area, noting that “many lower paid workers being paid through such schemes do not understand the arrangements and in many cases are given little choice as to whether or not they are paid through such schemes.” It went on to explain that it would “continue to investigate and challenge non-compliant Employment Businesses and umbrella companies and will report to ministers in due course on the outcome of that action and the extent of issues being discovered.” Individual workers with concerns about the minimum wage or their rights as an agency worker were advised to report these in confidence to the Pay and Work Rights Helpline (0800 917 2368), whereas those with concerns about other employment rights should contact Acas Helpline (08457 474747). 164

In February 2010 HMRC consulted on the potential exploitation by means of this type of salary sacrifice scheme of workers earning close to the National Minimum Wage (NMW):

A number of problems arise as a result of NMW workers’ participation in travel and subsistence schemes. Firstly, the reduction in their pay for tax and NICs purposes in return for the payment of tax and NICs free travel expenses can adversely impact on NMW workers’ access to earnings-related contributory

161 op.cit. pp 12-14
162 op.cit. p18
163 Cm 7484 November 2008 para 5.104
164 HMRC, Revenue & Customs Brief 50/09: Temporary workers: The application of Tax, National insurance and National minimum wage legislation, 6 August 2009
benefits. In addition, the cases that HMRC have seen suggest a worker participating in a travel and subsistence scheme is only very slightly better off in terms of take home pay. In some schemes, it is the Employment Business or umbrella company employing the worker who retains the largest part of any financial benefits, with only a small proportion of these being passed on to the worker.

Some businesses do not wish to implement travel and subsistence schemes for NMW workers as they consider that they involve profiting from low paid workers. Also, some businesses, for a number of reasons, are not able to implement such schemes. Such businesses suffer a competitive disadvantage compared to those businesses which do implement these schemes. Also, the participation of NMW workers in travel and subsistence schemes gives rise to an Exchequer risk, as not all NMW pay is subject to tax and NICs.165

In July it was announced that changes to the NMW regulations would be made to prevent home to work travel expenses counting towards NMW pay. At the time the Government noted that the industry was strongly split on any action being taken, but that the problems created by the use of these schemes merited action:

The Government received a total of 54 responses. These were split very much into two groups: those very strongly in favour of action and those very strongly opposed. More than 20 of the responses were received from Employment Businesses and umbrella companies which seemed to have implemented, or which wanted to implement, a travel and subsistence scheme. The vast majority of these were against any action being taken to prevent NMW workers being able to participate in these schemes. However, other Employment Businesses, of which a few advised that they were of a significant size, placing in excess of 10,000 workers each week, together with some representative bodies, wholeheartedly agreed that action should be taken.

The Government has considered carefully the responses from interested parties and on balance considers that action should be taken in relation to these arrangements where they involve NMW workers. Many of the responses received pointed out that these schemes do involve exploitation of the low paid, with the benefits skewed towards the Employment Business. There is also evidence, even from those opposed to the proposals, that these NMW workers, who represent some of the most vulnerable, do not understand the arrangements or their implications.166

These changes were made by Order later that same year.167

During 2012 there was some discussion of the issue, with concerns raised by the Low Incomes Tax Reform Group,168 and it being raised in

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165 HMG, *NMW workers: Travel and subsistence expenses schemes*, February 2010 para 1.5-6
166 A summary of responses to NMW workers: travel and subsistence expenses schemes, July 2010 paras 1.4-5
167 SI 2010/3001. The regulations were debated and approved in the House in November & December (Second Delegated Legislation Committee, 29 November 2010; HL Deb 8 December 2010 cc60-70GC)
168 LITRG press notice, *Tax campaigners warn of growing worker exploitation around misuse of limited companies*, 8 November 2012
several PQs,\textsuperscript{169} including one on the specific question of the mechanism for providing dispensations:

\textbf{Sir Peter Bottomley:} To ask the Chancellor of the Exchequer (1) (a) how many and (b) which employment agencies or umbrella companies operating travel and subsistence schemes have been awarded dispensations to operate such schemes by HM Revenue and Customs; (2) how many employment agencies or umbrella companies that have received dispensations to operate travel and subsistence schemes have been audited to verify that they are fulfilling the conditions of the dispensation.

\textbf{Mr Gauke:} HMRC does not issue dispensations to businesses to operate travel and subsistence schemes.

HMRC issues dispensations to cover certain payments of expenses for which an employee would otherwise get a full tax deduction. It is a mechanism which removes the need for an employer to report the relevant expenses payments on forms P11D or P9D and also removes the need for tax to be paid on those expenses and then reclaimed. Expenses payments covered by a dispensation are normally also disregarded for national insurance contributions (NICS) purposes.

HMRC reviews all dispensations regularly to ensure that the terms and conditions under which they are issued still apply. They have a specialist team which reviews dispensations for those operating in the temporary labour market to ensure consistency.\textsuperscript{170}

In early 2012 HMRC won a major case involving salary sacrifice schemes used by the Reed group of employment agencies for several years.\textsuperscript{171} The schemes had involved about 500,000 temporary workers covered by contracts that saw them give up a notional amount of their pay, receiving in turn a payment from the agency to cover lunch and commuting costs. The Tribunal ruled that these arrangements were bogus – the arrangements being so opaque that employees rarely had any idea of what part of their pay was being ‘sacrificed’ – and that workers were actually engaged on a series of job-by-job contracts.

In November 2012 several Members raised this issue in a debate on fuel duty, when they made the case that reducing avoidance in this area would free up resources to allow a cut in the duty rate;\textsuperscript{172} speaking for the Opposition, Cathy Jamieson said:

\begin{quote}
There is a growing problem with some employment agencies forcing workers to become employees of umbrella companies. They then falsely inflate the workers’ travel and other expense claims, reducing tax and national insurance and pocketing the avoided tax as profits. Her Majesty’s Revenue and Customs forecast in 2008 that the cost to the Exchequer of that avoidance would be around £650m by 2012-13. More recent reports have suggested that the current tax loss could be as high as £1bn.\textsuperscript{173}
\end{quote}

\textsuperscript{169} eg, HC Deb 30 October 2012 c210W & HC Deb 1 March 2013 c679W, c678W. The latter refers to HMRC guidance for those using recruitment agencies to ensure the agency is complying with the law: \textit{Use of Labour Providers : Advice on due diligence}, November 2014

\textsuperscript{170} HC Deb 17 December 2012 c567W

\textsuperscript{171} Reed Employment v HMRC [2012] UKFTT 28. For a discussion of the case see, "No sacrifice at all", \textit{Taxation}, 2 February 2012

\textsuperscript{172} HC Deb 12 November 2012 cc89-141

\textsuperscript{173} HC Deb 12 November 2012 c95
In his response to the debate the Treasury Minister David Gauke argued that the risk to tax receipts was not as serious as made out by the Opposition. In setting out the Government’s general approach to reducing tax avoidance, the Minister alluded to HMRC’s victory in the courts earlier in the year (emphasis added):

In an article, the shadow Chancellor—who, of course, is not here today to defend his own policies—wrote of tax avoidance: “Ministers have failed to take tough action to stop it happening.” What he did not mention was that the Ministers in question must have been those who consulted on the matter in 2008 and then decided not to change the law. Even four years on, the shadow Chancellor cannot stop himself briefing against the Treasury team of the right hon. Member for Edinburgh South West.

Incidentally, HMRC has strengthened compliance in this area. It has, among other things, won a large case worth £158 million. Moreover, changes in the national minimum wage scored an increase of £90 million, while protecting low-paid workers.

The fact is that it is this Government who are reinvesting money in HMRC, enabling us to secure an additional yield of £7 billion by the end of the current Parliament. It is this Government who are increasing the number of people working in compliance and enforcement in HMRC. It is this Government who are introducing a general anti-abuse rule. It is this Government who have passed legislation to deal with disguised remuneration. None of those measures was introduced by the Labour party when it had the opportunity to do so.174

In their 2014 report, the House of Lords Committee on PSCs noted concerns raised by several witnesses about the exploitation of these rules, to the detriment of both individual workers and the Exchequer:

If an individual working for an umbrella company is engaged on an over-arching contract of employment they are able to claim tax deductible travel expenses covering journeys from home to work. Umbrella companies are able to apply for and operate an expenses dispensation, which allows them to omit relevant expenses from their annual benefit in kind (P11D) returns to HMRC.

The Low Incomes Tax Reform Group (LITRG) suggested that individuals are often encouraged into the use of umbrella companies by the promise of greater levels of take home pay. They contend that these levels are, in fact, generated by understating taxable pay and overstating tax deductible expenses. Any understatement of pay could lead to a reduction in the value of National Insurance contributions, to the potential detriment of an individual’s long term pension entitlements. A number of respondents to our call for evidence raised issues with the manner in which umbrella companies managed expenses dispensations …

HMRC acknowledged that abuse of expenses dispensations by umbrella companies was taking place. They stated that the taxing obligation in these cases would rest with the umbrella company and that, as such, HMRC would seek any tax or National Insurance from the umbrella, rather than the individual worker. Provisions exist, where appropriate, for recovering money personally from the officers of a company, or for transferring

174  HC Deb 12 November 2012 c132
liabilities for National Insurance owed to a director of the company concerned.

This approach is not reflected in some of the wider evidence that we heard. The LITRG suggested that any investigation into expense abuses by HMRC is likely to result in penalties or problems for the worker, rather than the umbrella company. Professional Passport suggested that when umbrella companies had, in the past, been found to be non-compliant, there had been “numerous examples where the umbrella shuts its doors and walks away leaving HMRC holding all the losses”. They also stated that they were not aware of any action taken against directors personally to recover any of these losses.175

In November 2014 the Low Incomes Tax Reform Group published a substantive report on this issue, focusing on the operation of so-called ‘Pay Day by Pay Day’ (PDPD) schemes, which sought to evade the changes made to NMW legislation in 2011:

PDPD schemes are a type of ‘umbrella’ arrangement. Under an umbrella arrangement, temporary workers who incur travel expenses receive ‘relief’ on those expenses because it converts a series of short-term agency posts into temporary workplaces under a single contract of employment. These are then ‘allowable’ expenses.

In a PDPD-style umbrella scheme, the employer applies this relief to the amount of expenses which the employee has incurred each pay day, with the effect that only the balance of their wages is subjected to Income Tax and National Insurance. The umbrella employer also benefits from paying reduced class 1 secondary National Insurance contributions, and usually deducts a fee from the workers’ pay packets for operating the scheme.

In 2011, HMRC declared PDPD schemes ‘non-compliant’, stating that they were ‘seeking to identify those businesses currently operating pay day by pay day relief models.’ In spite of this, LITRG’s research indicates that HMRC have not taken any PDPD operators to task. Indeed, up to 37% of those offering ‘umbrella schemes’ could still be taking on workers under PDPD-style arrangements ...

LITRG Chairman Anthony Thomas, [has] said: “HMRC have neglected to properly address the PDPD phenomenon … The time has come for the authorities to not only tackle the immediate, unsatisfactory situation regarding PDPD, but also to take a holistic look at what is driving workers to use these schemes in the first place. One of these factors is most certainly the gaps in the underlying tax and national insurance rules on travel expenses. Another is workers’ fear of sanctions and loss of benefits if they refuse work, even if it is offered on terms they do not understand.”176

It is not proposed to summarise the LITRG’s work, but for convenience the report’s executive summary is reproduced in the text box over the next two pages.

175  Personal service companies, HL Paper 160 of 2013-14, 7 April 2014 paras 174-8
176  LITRG press notice, UK tax system trapping low-paid workers in travel tax relief schemes, 20 November 2014
Executive summary

A combination of work insecurity along with often poor pay and disproportionate travel costs means that agency workers can face uniquely tough times. Further, despite them having a ‘temporary workplace’ in the ordinary, natural meaning of the word ‘temporary’ and having little ability to plan around the fixed commuting costs of those in a permanent employment, there is no recognition of their expenses in the UK tax system.

Umbrella companies provide a framework within which an agency worker’s successive work locations can be turned into ‘temporary workplaces’ for the purposes of securing them some ‘relief’ under our outdated travel expense rules.

Such arrangements are controversial – to some they are not within the spirit of the law but to others they provide nothing more than a ‘straightforward’ tax advantage – a bit like Personal Service Companies for example. This may explain why we have seen inconsistent and sometimes contradictory messages being sent out by policymakers on the desirability of such schemes.

Nevertheless, they have been allowed to subsist although this has been accompanied by a seeming reluctance by HMRC to engage with responsible umbrella companies in reaching consensus on a compliant model – we think this may well have contributed to there being a vast spectrum of operators in the market place.

Worried about the effect of some of the more cavalier operators on agency workers, in 2011, NMW legislation was introduced that essentially put an end to umbrella schemes as a means of engaging the labour of the low-paid. This saw many employees’ take home pay fall overnight, despite the fact that at least half of the consultation responses on the matter had called for the impact to be assessed in more detail before proceeding.

Further, the resulting NMW legislative amendment was not wholly effective (‘imperfect’ as one judge described it) and in an industry full of creative thinkers, other schemes were created to exploit this – including one based on traditional umbrella arrangements called ‘Pay Day by Pay Day’ (PDPD). This claims to meet the new NMW rules but still help workers make savings, with tax and National Insurance contributions (NIC) being applied to the workers’ net (after-expenses) income. This essentially results in unreimbursed travel expense relief being administered at source by the employer, supposedly assessed by reference to the employee’s actual expenses each pay period – hence the name ‘Pay Day by Pay Day’.

The scheme providers say that this relief-at-source mechanism is technically underpinned by the tax and social security legislation, and has been backed by QC opinion. However, in accordance with the more generally accepted interpretation of the law, these schemes fail to properly account for the correct tax or employee and employer NIC.

Despite HMRC taking the unusual step of publishing two statements warning that the relief-at-source mechanism was ‘non-compliant’ (and also a subsequent court case involving the Gangmasters Licensing Authority – the outcome of which was consistent with HMRC’s position) it can hardly be said that the authorities have shown any assertiveness in tackling the schemes. Certain advocates of the scheme are unfazed in any case – convinced that the arrangements are permitted. Ultimately it seems that this will be a matter for the courts to decide. However, whatever the outcome, a further dimension to be considered is that increasing numbers of people in the tax profession and more widely, consider that the law underpinning unreimbursed expenses (as it is more generally accepted at the moment) is flawed and needs to be looked at in any case – as recent work by the Office of Tax Simplification (OTS) calling for changes in this area testifies.
In December 2014 the Government published a discussion document to ascertain how serious this problem was, and what action should be taken to prevent it. As this explained, some changes to the rules regarding employee expenses were already in train, while HMRC were engaged in a much wider review of travel and subsistence expenses:

Alongside this review, following the Office of Tax Simplification (OTS) review of benefits and expenses, the government is also simplifying the rules for employers who wish to pay or reimburse qualifying expenses to their employees. As announced at

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It is hard to deny that a sensibly run PDPD scheme can (on the face of it) have some relatively useful features from the perspective of the low-paid agency worker in terms of helping to overcome some of those flaws. PDPD has therefore perhaps put HMRC in a difficult position – forcing them to confront the two difficult and complex concepts of umbrella arrangements and the treatment of unreimbursed expenses at the same time. This may explain why it seems to have been some time since PDPD providers were put under any real scrutiny by HMRC.

Both of these issues look set to be debated in detail as part of the recently announced Travel and Subsistence review – however, by the authorities’ own admission, this is going to be a ‘slow burner’. Meanwhile the uncertainty over the ‘legality’ of the scheme makes its use somewhat risky, but there are many reasons why workers use them – sometimes they are unaware of the problems with them (or even how they operate even on a basic level), other times it is because they feel no choice but to use them.

In the void that exists, PDPD is still being widely marketed and utilised by agency workers at or near the NMW. Yet involvement in such a scheme can see the workers being pursued later for underpaid tax by HMRC. On one view, this is unacceptable and HMRC ought instead to suppress this activity at its source. If HMRC consider that the schemes are non-compliant then they, as the department tasked with the responsibility of ‘collection and management’ of the UK tax system, should seek underpayments of Pay As You Earn (PAYE) at the source of the problem. The data in their various new sophisticated systems (such as Real Time Information (RTI)) means it should be quick and easy for their employer compliance function to identify the PDPD employers.

Further, they should then build a case against a PDPD provider, so that the various arguments for and against the model can be tested once and for all – certainty, after all, is one of the cornerstones of a good tax system.

In the mid to long term we recognise that a clampdown on PDPD (if indeed this is what the authorities intend) may only make things more messy as new schemes will come to market. As such, and with an eye on what is just and reasonable for the worker, we think it would save considerable effort all round if the authorities were to address the underlying anomalies in the framework that drive the need for agency workers to use such arrangements in the first place, rather than undertake yet further tinkering around the edges where complexities will flourish.

Put simply, we think that there needs to be a ‘fix’ of the base rules that currently serve to work against low paid agency workers. Now that some of the issues around travel and subsistence have been aired in this report, we hope that there can be an informed debate as to what this ‘fix’ should look like.

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177 Autumn Statement, Cm 8961, December 2014 para 2.147; HC Deb 16 December 2014 c79Wv. see also, “The Q&A. HMRC proposals on overarching employment contracts”, Tax Journal, 16 January 2015

178 The exemption applies to certain business expenses that have to be paid in the course of the employee’s work and where, if the employee had met the costs
Autumn Statement 2014, from 6 April 2016 employers will be able to pay or reimburse certain expenses without being required to report these payments to HMRC or apply for an agreement not to deduct tax from these payments in advance (known as a ‘dispensation’).

However, the exemption will not apply to expenses paid by the employer through a salary sacrifice scheme. This will prevent businesses engaging in these schemes to take advantage of the travel and subsistence rules to avoid paying the full amount of employer National Insurance on their workers’ pay. This will, in part, address some of the concerns raised in this paper …

The government is also undertaking a wider review of the tax rules for travel and subsistence expenses with a view to modernising these rules to reflect current practices. However, as any changes introduced as a result of the wider review will take a number of years to come into force, this discussion paper has been published now as the government cannot overlook the current avoidance.179

The consultation document set out two possible options to address this problem: either restricting expenses where a worker was supplied through a third party, or doing so only in cases where the worker was employed under an OAC:

One way to [tackle this problem] … would be to determine that where the individual is supplied through a third party the workplace of the end client would in all cases be a “permanent workplace”. In this case no relief for travel from home to workplace, and associated subsistence, would be available. This would apply whatever the form of the third party. This would not change the position of individuals who are directly employed by employers for short periods as they are currently treated as working at a “permanent workplace” …

The government is particularly interested in the potential impacts on Personal Service Companies (PSCs) of any changes to the rules on relief for travel and subsistence expenses available to people working through an employment intermediary. Those who provide their services through PSCs will (usually) have a single employment covering all of their different assignments (much like employees who have an OAC). This means that they will also often be eligible for travel and subsistence relief for home to work travel. However, the government will want to consider the impacts very carefully before taking final decisions on the overall approach and how it is applied in these circumstances …

An alternative option would be to restrict the availability of tax relief for travel from home to workplace, and associated subsistence costs, where the individual was employed by an intermediary specifically under an OAC. This could be accomplished by stopping OACs being treated for tax purposes as giving rise to a series of temporary “employments” under a permanent contract. This option would restrict access to existing rules for travel and subsistence to people employed under an OAC, rather than actually changing travel and subsistence rules, with the practical impact that the access of people employed under OACs to travel and subsistence is consistent with principle that the costs of ordinary themselves, they would have been able to claim tax relief. For example the cost of maintaining tools needed for the employee’s job.

179 HMRC, Employment Intermediaries: temporary workers – relief for travel and subsistence expenses, December 2014 pp7-8. The deadline for responses was 10 February 2015.
55  Personal service companies & IR35

commuting are not subject to tax relief. As this option would specifically or solely affect people employed under OACs, it would not have any impact on PSCs (unless they use an OAC).\textsuperscript{180}

Subsequently, in the 2015 Budget, the Government announced that HM Revenue & Customs would consult on proposals to restrict tax relief in these circumstances:

1.250 Autumn Statement 2014 announced that the government would review the growing use of overarching contracts of employment that allow some temporary workers and their employers to benefit from tax relief for home-to-work travel expenses ... As a result of the review, the government will change the rules to restrict travel and subsistence relief for workers engaged through an employment intermediary, such as an umbrella company or a personal service company, and under the supervision, direction and control of the end-user. This will take effect from April 2016 following a consultation on the detail of the changes ...

1.251 Stakeholders have also raised concerns that individuals do not understand how their take-home pay is affected by these arrangements. The government wants employment intermediaries to provide workers with greater transparency on how they are employed, and what they are being paid. The Department of Business Innovation and Skills will consult on these proposals on transparency later this year.\textsuperscript{181}

At the time the LITRG raised concerns that “in line with previous piecemeal reforms in this area, the proposals seem to leave some room for manoeuvre for ‘employment intermediaries’ to devise ever more ingenious new schemes”:

The Government [has] announced that it will indeed change the rules to restrict relief for workers – but only where they are under the supervision, direction and control of the end-user. These are concepts open to interpretation and could therefore have the effect of paving the way for different, but no less abusive, schemes.

Anthony Thomas, Chairman of the LITRG said: ... “As we have reported on in the past ...introducing new rules targeted on particular abuses, without addressing the underlying gaps in the system which cause people to turn to things like umbrella companies in the first place, just leaves the door open for other – often worse – arrangements to fill the void.

“Nothing but a wholesale and in-depth review taking into account not only the tax position of the workers, but the benefits, credits and NI contribution positions too, will provide a satisfactory end to this cycle.”\textsuperscript{182}

In the Budget on 8 July the new Conservative Government confirmed it would proceed with this initiative,\textsuperscript{183} and published a consultation document which summarised the proposed change as follows:

\textsuperscript{180} Employment Intermediaries: temporary workers – relief for travel and subsistence expenses, December 2014 paras 69-70, para 75
\textsuperscript{181} Budget 2015, HC 1093, March 2015 pp61-2. The report estimated that reforming the rules would raise around £160m a year (Table 2.1 – item 26).
\textsuperscript{182} LITRG press notice, ‘Clampdown’ on workers’ travel and subsistence expenses leaves loopholes, say tax charity, 18 March 2015
\textsuperscript{183} Budget 2015, HC 246, July 2015 para 2.182
The government is proposing to remove tax relief for ordinary commuting (in general, home-to-work travel and subsistence expenses) for workers who are:

- supplying personal services,
- engaged through an employment intermediary (including umbrella companies, certain employment businesses and personal service companies); and,
- subject to (or to the right of) the supervision, direction or control of any person.

The effect of this will be that individuals whose relationship with their engager is such that they look and act like employees, cannot claim relief on the everyday cost of travelling to work, when employed through an intermediary. This will ensure a level playing field for access to tax relief for travel and subsistence.\(^{184}\)

The document noted that “one key concern” of respondents to HMRC’s discussion document had been “that any narrow action against the increasing use of tax reliefs by umbrella company employees in particular, would still allow those employed through PSCs to claim tax relief on travel and subsistence costs, in potentially similar circumstances”:

As a consequence of the different treatment for different employment models, there were concerns that large numbers of contractors and agency workers would establish PSCs, leading to a potential loss to the Exchequer. The government recognises these concerns and has adapted the original proposals …

[It is proposed that] where a payment is made to a worker, employed through an employment intermediary for travel between their engagers’ workplace; and:

- the workers home, or,
- any other place the worker visits for non-work reasons, or,
- any place where the worker performs the duties of another job, or engagement

and,

- the worker is under supervision, direction or control in their employment,

then,

- these payments will likely be treated as earnings from employment, and therefore subject to Income Tax and NICs.

These proposals will put workers, employed through an intermediary on the same terms as other workers, contracted directly or through an employment business.\(^{185}\)

The document went on to set out how ‘employment intermediaries’ would be identified, and how they would be affected by removing this particular tax relief.\(^{186}\)

For the purposes of these changes, an employment intermediary will be defined as an entity, including a company, a partnership, or

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\(^{184}\) Employment Intermediaries and Tax Relief for Travel and Subsistence: consultation document, July 2015 p11. Full details of the consultation are on Gov.uk.

\(^{185}\) Employment Intermediaries and Tax Relief for Travel and Subsistence: consultation document, July 2015 p10, p12

\(^{186}\) op.cit. pp12-13
an individual, which interposes itself between a worker and the engager, as part of an arrangement for the worker to provide their personal services to the engager. An employment intermediary’s business must be substantially in the supply of labour services. Employment businesses, umbrella companies and PSCs will be within the definition. However, professional service firms that second staff to clients will not be caught by the new rules, as their business is not substantially in the supply of labour.

### Current position

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**Can be paid tax and NICs free travel and subsistence for home to work: Travel**

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**Cannot be paid tax and NICs free travel and subsistence for home to work: Travel**

### Proposed position

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**Cannot be paid tax and NICs free travel and subsistence for home to work: Travel**

The consultation closed on 30 September.

In the Autumn Statement in November, the Government confirmed that from 6 April 2016, tax relief on these expenses would “be restricted for individuals working through personal service companies where the intermediaries legislation applies.”\(^{187}\) HMRC published draft legislation for the 2016 Finance Bill on 9 December; this included draft provisions on these changes regarding travel costs, with a draft version of HMRC’s guidance on the new rules. HMRC’s tax information note, published at this time, gives a summary of this measure:

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\(^{187}\) *Autumn Statement, Cm 9162, November 2015 para 3.20*
Legislation will be introduced in Finance Bill 2016 to restrict access to relief for home to work travel and subsistence where a worker:

- personally provides services to another person
- is employed through an employment intermediary
- is under (the right of) the supervision, direction or control of any person, in the manner in which they undertake their work

Employment intermediary will be defined as a person, other than the worker or the client, who carries on a business (whether or not with a view to profit and whether or not in conjunction with any other business) of supplying labour.

Where the worker is within the charge of the intermediaries legislation this measure will only apply to those contracts where a deemed employment payment is made, or would be made if all the individual’s remuneration was not being taken as employment income. In these circumstances the supervision, direction or control test will not be used.\footnote{HMRC, Income Tax: employment intermediaries and relief for travel and subsistence: tax information & impact note, December 2015}

The note goes on to discuss the impact this could have on individuals, and on businesses:

**Impact on individuals, households and families**

It is estimated that the measure will affect around 430,000 individuals employed by umbrella companies and employment agencies over the course of a year.

The precise impact on any individual is difficult to predict as it will depend on the hours worked, rate of pay, level of expenses and (if employed through an umbrella company) the level of the fee charged by the company. Those on low pay could benefit from this measure; particularly if they are claiming few expenses and are still paying a fee …

**Impact on business including civil society organisations**

This measure is expected to have a negligible impact on businesses and civil society organisations.

Businesses may see a rise in the direct cost of hiring temporary and contract staff through employment intermediaries who are subject to the supervision, direction or control of any party. This rise will bring their costs in line with those employers who are currently taking on temporary workers without the use of employment intermediaries and are not benefitting from tax relief on travel and subsistence.

End engagers will also need to identify whether a worker is under supervision, direction or control (or the right thereof) in the manner they undertak work and will need to agree the process for ensuring this information is passed to the employment intermediary. Most end engagers will only need to take action where a worker is not under supervision, direction or control in the manner they undertake their work. Workers are assumed to be under supervision, direction or control, unless it is shown otherwise. This will not be necessary for those who are engaging
a PSC, as the eligibility for relief will be determined based on whether or not the intermediaries legislation (IR35) applies. It was estimated that this measure would raise £155m in 2016/17, rising to £175m the following year, before falling gradually to £145m by 2019/20.

As noted, HMRC have estimated that about 430,000 people work through umbrella companies and employment agencies on OACs at present – though these figures are not regularly collated:

**Asked by Rob Marris:** To ask Mr Chancellor of the Exchequer, what information HM Revenue and Customs holds on the number of people engaged in employment through an umbrella company in each year since 2008.

**Answered by: Mr David Gauke:** HM Revenue and Customs (HMRC) does not routinely record the information requested, but has published estimates on an ad hoc basis since 2008.

In 2008 HMRC published figures for the number of umbrella workers in a consultation document “Tax Relief for travel expenses: temporary workers and overarching employment contracts.” HMRC estimated that around 120 umbrella companies operating in the UK were using overarching contracts and employed around 100,000 temporary workers at any one time.

Evidence suggests that for 2013-14 the 50 largest umbrella companies alone employed 150,000 individuals over the course of a year. In 2015 an estimated 430,000 individuals were employed by umbrella companies and employment agencies on overarching contracts over the course of a year. The number at any one time will be less than this.

In the 2016 Budget the Government confirmed that it would introduce this legislation, to “bring the rules into line with those that apply to employees,” though certain amendments would be made in the light of responses to the draft legislation:

**Employment Intermediaries and tax relief for travel and subsistence**

As announced at the March Budget 2015 and following publication of draft legislation on 9 December 2015, the government will introduce legislation in Finance Bill 2016 to restrict tax relief for travel and subsistence expenses for workers engaged through an employment intermediary.

Following the publication of the draft legislation, amendments have been made to allow grouped companies to second workers within the group, and to prevent the organised misuse of Personal Service Companies in order to avoid the restrictions. Minor amendments have also been made to improve clarity and correct errors.

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189 ibid
190 HM Treasury, *Budget 2015 Policy Costings, March 2015* p22; *Budget 2016*, HC901, March 2016 p89 (Table 2.2 – item bl);
191 PQ37220, 23 May 2016
192 *Budget 2016*, HC901, March 2016 para 2.39
Provision to this effect was included in the Finance Bill 2016 published after the Budget. Subsequently the Government tabled a ‘technical amendment’ to the clause, along with a number of other amendments to the Bill:

A technical amendment is being made to clause 14, to ensure that it reflects the original policy intent, announced at Autumn Statement 15.

Clause 14 amends the provision in the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) allowing deductions from earnings made for travel and subsistence expenses, but only where a worker is engaged through an employment intermediary. The amendment corrects drafting so that the legislation will apply as intended to all workers supplying personal services through an employment intermediary where they are working under supervision, direction or control. The legislation remains unchanged for those working through a personal service company, where the new rules will apply only where the intermediaries legislation (IR35) applies.

These changes do not represent a change in policy, or impact the amount of revenue that we had forecast to raise from the measure.

There was relatively little press comment on these changes though the Low Incomes Tax Reform Group (LITRG) raised concerns that individuals might be misled as to how the new rules could affect them:

In order to get around the new rules and save themselves money, some businesses may ask their workers to operate under unusual terms and conditions. These should always be treated with the utmost caution by the workers.

The intention is that workers who are genuinely self-employed and running a business on their own account will not be caught by the new rules. Some less scrupulous entities may try to exploit this by saying that workers are not under the supervision, direction or control of any person (and thus are akin to self-employed) in order to get around the new restrictions and continue to claim relief on travel and subsistence expenses on the same basis as before. While it may be tempting to turn a blind eye to such questionable practices to continue to enjoy a higher wage, HMRC despite their own regulations often pursue the individual worker rather than the employer for PAYE under-deductions. It may therefore be the worker, not the employer, who ultimately bears the consequences.

Under a different but equally abusive type of arrangement, the worker may be treated as an employee for tax purposes (so that PAYE is operated as is required under law) but as self-employed for all other purposes. Self-employed people do not have the rights and protections that agency workers have, such as being paid at least the National Minimum Wage or National Living Wage and working time entitlements such as paid annual leave. Operating such a scheme may save the business concerned money, but is unlikely to benefit the worker in any way at all.

194 “Clause 14: Travel expenses of workers providing services through intermediaries”. Bill 155-EN, 24 March 2016
195 See, Commons Library Deposited paper DEP2016-0563, 14 June 2016 & Amendment to Clause 14: Explanatory Note, 14 June 2106.
Another scheme may involve working through a ‘Personal Service Company’ (PSC). This is a one person Limited Company which the worker may be told will not be caught by the new rules restricting travel and subsistence relief. This is not true – many arrangements involving PSCs will be caught; the business selling the worker the scheme is probably just relying on the fact that such arrangements can take a little longer for HMRC to investigate. In any case, due to the responsibilities and obligations associated in running one, providing services through a limited company may be totally inappropriate for the worker concerned and leave them with messy and expensive compliance issues to clean up for many years (by which time the business that helped set it up will be long gone!).

At this time HMRC published updated guidance for taxpayers who would potentially be affected by the new rules. The LITRG has also produced guidance for agency workers, and, in September 2017, a new factsheet to help temporary workers employed through umbrella companies.

There was relatively little comment on this measure in the House, although speaking for the SNP at the Finance Bill’s second reading, Roger Mullin argued that, “in an act of social and economic injustice, [the Government] are mounting an attack on small individual contractors who serve rural communities, preventing them from having travel expense relief. These people are not tax dodgers; they are flexible workers, with both private and public clients, who are essential to many rural communities in Scotland.” The potential impact of the new rules on supply teachers has also been raised in a PQ:

**Asked by Dan Jarvis**: To ask Mr Chancellor of the Exchequer, what assessment his Department has made of the potential effect on supply teachers of new restrictions on tax relief for travel and subsistence expenses for workers engaged through an employment intermediary.

**Answered by: Mr David Gauke**: The changes to tax relief for travel and subsistence only affect those who work through an employment intermediary. The planned changes will put supply teachers employed through an intermediary on the same terms as other supply teachers, either contracted directly, or through an agency contract.

The Government’s general assessment of the effects of the measure can be found in [HMRC’s Tax Information and Impact Note]. The Government undertook detailed consultation on these proposals. Further assessment can be found in [the summary of responses to the consultation document] published on this change.

Subsequently this clause was debated with several others at the start of the Committee stage, when selected clauses were debated on the floor of the House. On this occasion Treasury Minister David Gauke set out

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196 LITRG press notice, _Agency workers – new tax year, new troubles_, 6 April 2016
197 HMRC, _Employment intermediaries: travel expense guidance_, 26 April 2016
198 LITRG, _Agency Workers, updated November 2017_
199 LITRG press notice, _LITRG launch practical help for umbrella company workers_, 27 September 2017
200 HC Deb 11 April 2016 c117
201 PQ37899, 23 May 2016
202 HC Deb 27 June 2016 cc 67-95
the Government’s case for this reform, and responded to Members’ particular concerns that this might disadvantage taxpayers living in rural areas – in that they were more likely to travel longer distances for work – or those in specific sectors, such as supply teaching. In the event the clause was agreed by the House without a vote. Extracts from the Minister’s comments are reproduced below:

For the vast majority of people, home-to-work costs do not have tax relief, and it is right to apply the same rules across the board. If there is a difference in treatment just because an arrangement is made through an umbrella company or other form of intermediary, clause 14 will put those workers on the same terms as everybody else. That underpins the Government’s commitment to ensure that the tax system is fair and treats all individuals who are doing the same thing in the same way ...

All Members recognise how important it is that we have an entrepreneurial economy, and that the importance of the self-employed in our economy is considerable. It does not seem, however, that there is a strong case for saying that a difference in tax relief should apply, which is why we have come forward with these measures. In recent years there has been a substantial increase in the number of workers engaged through an employment intermediary, and while many play a legitimate role in the labour market, increasingly some market themselves—at least in part—on the basis that they allow individuals and businesses to maximise their income through claiming tax relief on home-to-work travel expenses ...

A number of points were raised [by Members] on clause 14. It was asked whether this change would disadvantage rural communities. Workers in rural communities who are contracted directly cannot claim travel and subsistence on their ordinary home to work commute. This change equalises the tax treatment of workers employed through employment intermediaries with that of other workers …

In terms of whether it would reduce contractors’ ability to travel, creating a skills shortage or reducing flexibility and preventing growth, where businesses wish or need to recruit workers living some distance away, the Government expect businesses to pay a wage sufficient to attract workers without any special tax subsidy being necessary. This forms part of the Government’s plan to move to a high-wage economy with businesses meeting the costs of paying their workers a wage which does not require a top-up from the state.

I should also make the point in this context that this change puts supply teachers —an example that I think was used in the course of the debate—who are engaged through an intermediary on the same terms as other supply teachers who are contracted directly or through an agency. Like other workers, supply teachers not engaged in this way would not receive tax relief on their travel and subsistence expenses on regular home to work travel.\(^{203}\)

\(^{203}\) *op. cit. cc70-1, cc88-9*
5.4 Improving the effectiveness of IR35 (Summer Budget 2015)

In its Summer Budget the new Conservative Government also announced that it would publish a discussion paper on IR35, with a view to improve its effectiveness.204

The paper, published later in July, did not make definitive proposals, but asked for views on several options, given that “non-compliance with the legislation is widespread.”205 It noted that it was “very difficult to create and enforce a system that addresses the problem of disguised employment which doesn’t also have some impact on those who are genuinely self-employed and operating through a company for legitimate, commercial reasons.”206 Making administrative changes or strengthening HMRC’s compliance response were unlikely to tackle the problem, so more fundamental reform might be necessary – such as putting on the onus of deciding whether IR35 applied or not on the engager, rather than the PSC. Doing this without creating considerable complexities could require simplifying the tests for applying IR35.207

The paper is discussed in more detail below. At the outset it is worth underlining that the Government took the view that this was very much a preliminary stage to any reform. It stated that would “use this stage of the consultation process to better understand the issues”:

> If the government decides to proceed with reforming the rules, any proposals will undergo a full consultation so that interested parties can contribute their views for consideration. The detail and timetable for further consultation will depend on the outcome of the discussions HMRC will have with stakeholders following publication of this discussion document.208

Comments were invited by the end of September 2015.

The paper argued that the incentives to ‘disguise’ employment through a PSC had grown “as NICs rates and the Personal Allowance have increased and Corporation Tax rates have fallen.”209 While the number of individuals paying tax under IR35 had remained “fairly static”, there had been a “substantial increase” in the number of PSCs:

> The government estimates that there were around 265,000 PSCs in 2012-13, an increase of 65,000 on the previous year alone.210 This number is expected to continue to increase.

> Whilst many PSCs would not fall within the legislation because the worker would properly be regarded as self-employed, the government would still expect to see a larger increase in the number of people paying tax and NICs under IR35.

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204 Budget 2015, HC 246, July 2015 para 2.183
206 op.cit. p7
209 op.cit. p3. The document gives two case studies to illustrate the potential tax savings from working through a PSC.
210 There is no statutory definition of a PSC and they are not precisely identifiable in the available data. The government has estimated the number of PSCs using a proxy. It is therefore subject to a degree of uncertainty.
around 10,000 people paid tax under IR35, an estimated 10% of those who should have paid tax on at least part of the income their PSC receives under the legislation.\(^{211}\)

The paper went on to discuss the problems of operating IR35, the costs from non-compliance, and the risk to the Exchequer should this grow:

HMRC take a risk based approach to identify non-compliant cases so activity is targeted in the most cost effective way, concentrating on the high risk cases. However, carrying out IR35 interventions can be complex and time consuming.

One of the challenges is that responsibility for operating IR35 sits with the PSC itself and applies on a contract by contract basis. That means HMRC currently has to enquire into each individual PSC for each individual engagement, even where several PSCs are working for the same engager, often under what appear to be the same terms. Several parties may be involved in the contractual chain in each case and reaching agreement with all of them on their understanding of the contractual arrangements can be complex. There is also insufficient clarity concerning each party’s responsibility for cooperation with HMRC interventions. …

The government estimates that noncompliance with the legislation will cost the Exchequer £430m in tax and NICs receipts this year and, without reform, it expects this loss to continue to grow. There is also a risk that non-compliance will erode the behavioural impact of the current legislation, which would come at a further cost to the Exchequer. The deterrent effect of the legislation was estimated to protect around £520m of tax receipts in 2010-11.\(^{212}\)

The reports of both the OTS and the Lords Select Committee on PSCs had recognised that there were “no easy answers to reforming the legislation.” Nevertheless the Government argued that changing IR35’s administration or boosting HMRC’s compliance activity were unlikely to tackle the problem, alone:

HMRC, along with the IR35 Forum, [reviewed] … the administrative approach to IR35 … in January 2015. Whilst this had some positive outcomes, it doesn’t fully address the shortcomings of the current rules. Another option could be to further improve HMRC’s compliance response but … the government does not believe this alone is sufficient to tackle the size of the problem as interventions focus on each individual engagement and often require input from several parties, not all of whom have a clear responsibility to cooperate with HMRC.\(^{213}\)

The paper asked for views on requiring engagers to have more of a role “in ensuring that the right amount of employment taxes are paid”, and whether the test for applying IR35 might be simplified:

Under such an arrangement, those who engage a worker through a PSC would need to consider whether or not IR35 applies (in the same way as they would need to consider whether a worker should be self-employed or actually be an employee), and, if so, deduct the correct amounts of income tax and NICs as they would for direct employees …

\(^{211}\) op.cit. p4

\(^{212}\) op.cit. p5

\(^{213}\) op.cit. p7
Many stakeholders have noted the complexity associated with identifying whether or not IR35 applies as being an area of difficulty for some. Therefore, an element of any reform could be to simplify the test for determining if IR35 applies. One option could be to align the test with that used for temporary workers in the agency rules, which is based on supervision, direction or control. Another option could be to look again at some of the suggestions considered by the OTS, such as requiring an engagement to last a certain minimum amount of time to be considered one of employment.\(^{214}\)

At this time the Government commissioned two new inquiries from the OTS, while confirming it would be established on a statutory basis as a permanent office of HM Treasury: namely, the closer alignment of income tax and NICs, and, the taxation of small companies.\(^{215}\) The intermediaries legislation did not feature in the terms of reference for either project, though, in the latter case, the Government emphasized that the OTS would “liaise closely with that work stream.”\(^{216}\)

In early November there were press reports that Ministers were considering whether any contractor whose placement lasted more than a month would have to go onto the client’s payroll as their employee.\(^{217}\) No official statement was made at the time and although the Autumn Statement confirmed changes to the tax treatment of travel and subsistence expenses – discussed above – it made no mention of IR35.

In October 2015 Treasury Minister David Gauke wrote to the House of Lords Committee on PSCs, to give an update on the Government’s response to its report; in this Mr Gauke referred to the ongoing consultation launched in July, and underlined that the Government were “looking for a solution that protects revenue and improves fairness in the system.”\(^{218}\) In answer to a PQ on 1 December about the Government’s response to this consultation the Treasury Minister Lord O’Neill said “the discussion period concluded on 30 September, following the receipt of over 160 responses and 14 roundtable meetings. The Government is now considering the responses.”\(^{219}\) Subsequently, in answer to a PQ on 20 January, the Treasury Minister David Gauke confirmed that this was process was ongoing.\(^{220}\)

In March 2016 the OTS completed its review of the closer alignment of income tax and NICs;\(^{221}\) the report set out a series of steps that could be taken, but went on to argue that a lot more work should be done on the impact of reform “so that informed choices on how to proceed can

\(^{214}\) op.cit. p8
\(^{216}\) Office of Tax Simplification, OTS review of small company taxation – Terms of Reference, 21 July 2015
\(^{217}\) see, “Crackdown on personal service companies could raise £400m in tax”, Guardian, 6 November 2015; and, “Osborne to close tax loophole of staff being paid ‘off the books’”, Daily Mail, 6 November 2015
\(^{218}\) Letter from the Financial Secretary to Lord Lamming, 5 October 2015
\(^{219}\) HPLO2663, 1 December 2015
\(^{220}\) PQ22025, 20 January 2016
\(^{221}\) OTS press notice, 7 March 2016
in due course be made.”222 In turn the Government agreed the OTS should carry out two further reviews: the impact of moving employee NICs to an annual, cumulative and aggregated basis, and, the reform of employer NICs.223 In November 2016 the OTS published a second report, recommending a series of reforms to both employee and employer NICs to be phased in over a five year period.224 However, the Chancellor Philip Hammond wrote to the OTS later that month, acknowledging that there was a case for having NICs calculated on an annual basis, but expressing his view that it was not “the right time to make this major reform.” Officials would keep options for reforming employer NICs “under review.”225

Finally, as noted in section 4 of this paper, Budget 2016 announced that “from April 2017 the government will make public sector bodies and agencies responsible for operating the tax rules that apply to off-payroll working through limited companies in the public sector.”226 In May HMRC launched a consultation on this initiative. The proposals are discussed at length in the next section of this paper, but in brief, HMRC set out a new process for engagers to determine if workers are within the scope of the new rules – whether the engager is a public sector organisation, or an agency supplying workers to a public sector organisation.

The consultation document also included a summary of the issues raised by the 2015 discussion paper, and the Government’s responses to them. As this notes, the majority of respondents were strongly opposed to transferring the responsibility for operating IR35:

Many said such a change would impose a costly and significant burden on businesses and referenced the cost of new payroll and allocation systems. Respondents also said they feared engagers would not have the necessary skills or knowledge to make decisions about whether the rules apply.

Some respondents said transferring the liability to the engager would cause over compliance, resulting in the risk of ‘false employment’. As engagers tend to be risk averse, they would assume contracts fall within the rules to protect themselves and contracts that should not be caught by the rules would become subject to employment taxes. Respondents felt this could also result in increased litigation for HMRC.

Respondents were concerned they could be held responsible for any mistakes made by the PSC in its tax affairs.227

222 Closer alignment of income tax and national insurance contributions, March 2016.

In their report the OTS noted that although IR35 was out of the remit of this particular project “we have inevitably had a lot of comment relating to [it]” (p7).

223 Letter from the Financial Secretary to the Office of Tax Simplification following Budget 2016, 24 March 2016

224 OTS, Closer alignment of income tax and national insurance: at a glance, November 2016. The full report and other material is on the OTS’ site.

225 Letter from the Chancellor to the OTS, 23 November 2016

226 Budget 2016, HC 901, March 2016 para 2.40

227 Off-payroll working in the public sector: reform of the intermediaries legislation, May 2016 p36. See also, PQ58072, 20 December 2016
A similar consensus against a shift of compliance responsibilities was reported in an HMRC-commissioned survey of employers’ views on IR35 published at this time.\(^{228}\)

Most respondents to the 2015 discussion paper also opposed using supervision, direction or control (SDC) as a test for whether IR35 applied in an individual case:

Most responded negatively to this proposal saying the SDC test was too vague and too subjective and would significantly widen the scope of the rules. One accountancy body said the test was limited in scope and other factors should be taken into consideration, such as mutuality of obligation, financial risk and the length of engagement. Most respondents felt SDC would not be appropriate for the intermediaries rules.\(^{229}\)

In the light of this, the Government stated that its focus would be on amending the rules as they apply to the public sector – and developing its online services, which could also benefit the private sector:

The government acknowledges there is potential for burdens on business to increase if responsibility for determining the rules was moved to the engager. This is why the government announced the reform would be for the public sector only, and why this consultation seeks views on a new test and the development of an online tool. Together, these should make the decision on whether a worker is in scope for the rules simple and quicker for most situations …

The government recognises concerns that using supervision, direction or control as a test would widen the scope of the rules. The government instead is consulting on the development of a new, simple decision-making process and an online tool.\(^{230}\)

The Government also explicitly ruled out a test for applying IR35 based on the length of the relevant contract:

Many respondents suggested a new test, based on length of contract (similar to the test used in Australia), should be introduced to rule people in or out of the scope of the rules … The government does not consider that a test of duration is appropriate. It would require complex further anti-avoidance legislation to prevent contrived arrangements and disproportionate resources to police.\(^{231}\)

\(^{228}\) HMRC, *Intermediaries legislation qualitative research – HMRC Research report 410*, July 2016

\(^{229}\) *Off-payroll working in the public sector, May 2016*, p37

\(^{230}\) *op.cit. pp36-7*

\(^{231}\) *op.cit. p38*
6. IR35 and the public sector (2016-17)

6.1 Budget 2016

In the 2016 Budget report the Government announced that public sector bodies would be made responsible for ensuring that any contractors they engaged were compliant with the IR35 rules:

**Off-payroll engagement in the public sector**

1.148 Some individuals who work through their own limited company are undertaking jobs that would ordinarily mean they are employees of the business that they are working for. In those circumstances, existing legislation on off-payroll working requires them to pay broadly the same taxes as employees. However, non-compliance with these rules is costing the taxpayer around £440 million a year – and these costs are rising (HMRC analysis of taxpayer data.)

1.149 Public sector bodies have a responsibility to taxpayers to ensure that the people working for them are paying the right tax. From April 2017, where the public sector engages an off-payroll worker through their own limited company, that body (or the recruiting agency if the public sector body engages through one) will become responsible for determining whether the rules should apply, and for paying the right tax. This strengthens the public sector’s role in ensuring that the workers it engages comply with the rules.

1.150 The government also recognises that the current rules are seen as complex and can create uncertainty. It will therefore consult on a simpler set of tests and online tools that will provide a clear answer as to whether and when the rules should apply.232

Initially it was estimated this measure would raise £265m in 2017/18, though considerably less in later years.233

HMRC published a short note alongside the Budget on the proposed scope of the rules, and the mechanism for paying the right amount of tax, with a few worked examples.234

The Government’s announcement was noted by the Public Accounts Committee, in a report on the use of consultations and temporary staff, published the following month. The Committee raised concerns that departments were not “doing all they can to ensure temporary staff pay the right tax”, and recommended that the Treasury should re-evaluate its guidelines in the light of this policy decision:

Off-payroll arrangements are not appropriate for those in management positions or those working for a significant period with the same employer, and we are concerned that the numbers of these arrangements may rise as departments rely more on temporary staff. We note the announcement in the March budget, after we had taken evidence in February that the

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232  Budget 2016, HC901 March 2016 p43
233  op.cit. p85 (Table 2.1 – item 40)
234  Off-payroll working in the public sector: reforming the intermediaries legislation, March 2016
Government intends to place a duty on public sector organisations from April 2017 to ensure that their staff do not obtain a tax advantage by contracting through a personal service company for providing services on the same basis as employees.

Recommendation: HM Treasury should re-evaluate its guidelines to departments in the light of Budget 2016. It should also require that departments immediately review whether their off-payroll staff should be on PAYE and, after April 2017, that departments review the calculation of tax for a sample of any temporary staff who continue to be contracted as a company.\(^\text{235}\)

### 6.2 Consultation on reforms (Summer 2016)

In May 2016 HMRC launched a consultation on this reform, with a view to introducing legislation in Finance Bill 2017. Responses were invited by 18 August 2016.

The paper provided a hypothetical example of how the new rules would work in practice.

For any new contract, contractors would instigate a two-part process – first to consider if a contract potentially fell under the scope of IR35, then, if they did, to use an interactive online tool provided by HMRC to make a definitive decision, and deduct tax at source as necessary; this is reproduced over the following two pages:\(^\text{236}\)

**Example 5: The decision making process**

A local authority needs cover for 3 months maternity leave – possibly longer. Christine is a retired social worker and agrees with the Human Resources (HR) Manager to provide locum cover through her PSC. She is highly skilled and needs little day to day support. HR draws up a contract with Christine’s PSC which sets out what she must do.

She must:

- report to the senior social worker on the team
- obtain legal sign off for certain decisions
- follow the governance guidelines
- work cases as directed

She is paid a daily rate and her contract is terminable at one week’s notice. Diagram 1 shows how the local authority will make the decision about whether the rules apply, and how it and her PSC will deal with payments.

\(^\text{235}\) Public Accounts Committee, *Use of consultants and temporary staff*, 22 April 2016, HC 726 of 2015-6 p6

\(^\text{236}\) *Off-payroll working in the public sector: reform of the intermediaries legislation, May 2016* pp15-17
Box 1
HR considers the first part of the gateway process using the HMRC online tool to see if the rules apply:
- Is the a public sector engager—yes
- Are they hiring through an agency? — no
- Is 20% or more of the worker’s contract for materials used? — no
- Does the worker own their own company? — yes

Result — needs to consider further tests

Box 2
HR considers the second part of the process
- She can’t in practice send a substitute because of case sensitivity
- There are some strong elements of control in the contract

Result — Christine is in scope

Box 3
The online tool shows that the new rules apply and the local authority has to operate Pay As You Earn and National Insurance as though Christine was employed directly by them

Box 4
A contract is drawn up with Christine’s PSC

Box 5
The local authority pays Christine £x a month after taking out £x for tax and £x for National Insurance Contributions

Box 6
HR sets Christine up on its payroll using the right tax code and her National Insurance number (by using the starter checklist) and go through the RTI process as follows:
- Each monthly payment to the PSC will be reported to HMRC on or before the payment date
- The tax/National Insurance deductions will be paid by 19th or 22nd the following month
- The local authority also pays employers’ National Insurance as secondary contributor through RTI

Box 7
HMRC receives the tax and National Insurance

Box 8
Christine could, for example, take a salary or dividends from her PSC. Off-setting is required to make sure tax and National Insurance are not paid twice.
Stakeholders were also asked whether the 5% allowance – a flat rate allowance that PSCs may claim against income taxed under IR35 – should be retained in these circumstances:

**The 5% allowance**

When the intermediaries legislation was introduced it allowed a 5% deduction for notional expenses. This is intended to allow for the general expenses of running a business, such as the cost of training and looking for contracts. Retaining this allowance would effectively give public sector engagers a 5% deduction on the amount on which they will be required to pay employers National Insurance. This is because the 5% is deducted from gross pay before tax and employers National Insurance are calculated.

The government would like to explore how keeping this allowance would work in practice as retaining it may make the process of accounting for tax more complicated for engagers and for the PSC when it has to account for other taxes such as VAT and Corporation Tax.237

In July 2016 the Government published its response to a number of reports by the Public Accounts Committee, including the PAC’s report on temporary staff; in this case, the Government accepted the PAC’s recommendation, underlining its intention to implement this reform from April 2017:

The Treasury will consider whether its guidelines need amending following the Budget 2016 announcement of proposed reform in the public sector of the tax legislation on off-payroll limited company workers. HM Revenue and Customs published a consultation on these changes on 6 May 2016. Following this, the Treasury will consider whether changes to the guidelines are necessary. The existing guidance will continue to require departments to review whether off-payroll staff should be on PAYE. After April 2017, the new tax rules announced at Budget 2016 will apply.238

There was relatively little comment on the consultation in the press, or in the House, though the Financial Times quoted Mark Groom, a partner at Deloitte, suggesting that it was likely that this model was likely to be applied to the private sector at some point in the future:

HMRC says its plan applies only to contracts that self-employed staff undertake in the public sector, although accountants believe it will eventually be extended to private sector companies, such as banks and asset managers. Mark Groom, a partner at professional services group Deloitte, said: “The government will first get its own house in order and show that the public sector is doing things properly. "The implication is that this then extends to the private sector, as a two-tier tax system for contractors would be odd.”239

In the Autumn Statement the Government confirmed its plans, and announced that individuals working in the public sector would not be entitled to claim the 5% allowance:

237  op.cit. p19
238  Treasury Minutes, Cm 9323, July 2016 p10
239  “Contractors risk pay cut after tax clampdown”, Financial Times, 6 July 2016. See also, PQ47016, 17 October 2016.
Off-payroll working rules – Following consultation, the government will reform the off-payroll working rules in the public sector from April 2017 by moving responsibility for operating them, and paying the correct tax, to the body paying the worker’s company. The government believes public sector bodies have a duty to ensure that those who work for them pay the right amount of tax. This reform will help to tackle the high levels of non-compliance with the current rules and means that those working in a similar way to employees in the public sector will pay the same taxes as employees.

In response to feedback during the consultation, the 5% tax-free allowance will be removed for those working in the public sector, reflecting the fact that workers no longer bear the administrative burden of deciding whether the rules apply.240

6.3 Outcome of consultation (December 2016)

The next month the Government published draft legislation for the 2017 Finance Bill on 5 December, including draft provisions on this measure. HMRC published a technical note with a series of worked examples on how the rules would work, a tax information note, and a summary of the responses it had had to the consultation. The Chief Secretary to the Treasury also wrote to Secretaries of State to set out the implications of this reform.241

In its summary of the consultation, HMRC reported that a majority of responses had agreed the rules needed reform, though some questioned whether the Government should undertake a ‘fundamental review of employment status’:

Most responses agreed that it was necessary to reform the rules and with the principle underlying the need for the rules: one public sector body commented that ‘[w]e agree wholeheartedly with the principle that people who do the same job in the same manner pay broadly similar amounts of income tax and National Insurance…’

Some were concerned that the changes would be a blueprint for reform to the private sector and others questioned why the reform targeted the public sector alone.

Several respondents, whilst agreeing that there is an issue with the levels of compliance with the legislation, thought that there were other options to tackle the problem, such as a new tax status for freelancers. A few responses called for the government to undertake a fundamental review of employment status to take account of ‘the rapidly changing world of work’.242

240 Autumn Statement, Cm 9362, November 2016 para 4.11. The report’s costing of the decisions announced in the Statement increased the anticipated annual revenue gain from this measure by £20-£25m (Table 2.1 – item 43). See also, HM Treasury, Autumn Statement policy costings, November 2016 p43.
241 Chief Secretary to the Treasury letter to Secretaries of State: off payroll working rules in the public sector, 5 December 2016
In response the Government underlined that it had “no current plans to extend the reform beyond the public sector”:

The government agrees that reform of the off-payroll rules is needed.

It is important to ensure that public funds are correctly used and that those in receipt of them are paying the correct taxes. Some public sector bodies are already required to check that some of their off-payroll workers are paying the correct taxes under the off-payroll assurance processes introduced by HM Treasury in 2012. These are limited to engagements of over six months and over £220 per day. Although public procurement rules encourage engagers to take on a greater role in tax assurance, compliance across the wider public sector remains low and presents a significant fiscal risk. The criteria for deciding whether the rules apply will remain the same for both the private and public sectors.

The reform means that the public sector engager (or agency in the chain if there is one) will be responsible for applying the rules and liable for paying any associated tax and NICs to HMRC. For private sector engagers the PSC will still be responsible for applying the rules. The government has no current plans to extend the reform beyond the public sector. A new online tool will be available by April 2017 for all to use and will make it easier to apply the rules regardless of sector.

The Prime Minister has recently asked Matthew Taylor to lead an independent review into how employment practices need to change in order to keep pace with modern business models. The government awaits the outcome of that review with interest.

Two other concerns were raised by stakeholders: that this reform would have a negative impact on the labour market, and that the time scale for implementation would impose significant burdens on public sector clients. In answer to the first point, the Government emphasized that the purpose of the reform was to improve compliance with the existing rules – and that public sector bodies would continue to be able to take on off-payroll workers:

**Impact on the UK’s labour market and the public sector**

**Consultation response**: Some respondents were concerned that the reform would stop people working through limited companies and this could negatively affect the flexibility of the UK labour market, with a small number suggesting that the government’s purpose was to stop people using this company structure. Many contractors and their representatives said they would choose not to work for the public sector as a result of the reform. Some contractors said they would have to consider whether their rates would need to change to take account of the increased tax and NICs that would become due. They said that if rates rise this could lead to skills shortages in key sectors such as IT and engineering and increase public sector hiring costs.

**Government response**: The government recognises the benefit to the economy of having a flexible labour market and has no intention of stopping people from working in this way. Public sector bodies will continue to be able to hire contractors, including those who choose to operate through their own company. The government is not increasing...
the numbers of people who should be subject to the off-payroll legislation: the changes are intended to improve compliance with the current rules where they are not being operated correctly.

However, the government does not believe that choosing to work through a limited company should necessarily affect the amount of tax and NICs an individual pays. Where an individual would have been taxed as an employee had they been engaged directly, rather than through an intermediary, it is right that they should pay broadly the same tax as an employee. Individuals doing the same job should be treated similarly, regardless of whether or not they work through a company. People who are genuinely self-employed – and so outside the intermediaries rules – will not be impacted by this change.244

On the timing of this reform, the Government argued that it was important to implement these changes as soon as possible, given the ongoing Exchequer cost of non-compliance, and that HMRC’s digital tool would substantially mitigate the transition costs of the new regime:

Implementation date
Consultation response: Respondents commented on the date for implementation of the reform and challenged whether it was deliverable in the proposed timescale. Some public sector organisations said that changes to processes would be costly and time-consuming and would not be ready in time for April 2017. Others commented that it would be simple to manage processes where they engaged smaller numbers of contractors. A few organisations said that the reform should be delayed until the online tool is fully ready, as making the decision would be overly burdensome without it.

Government response: It is important to implement reform as soon as possible to protect the Exchequer. However the government is aware that this will require changes to systems and processes. The government engaged early, and has been talking to stakeholders about reform of the off-payroll rules since last summer. HMRC has consulted extensively with payroll providers, public sector employers and agencies as part of this consultation. HMRC will be providing guidance prior to implementation in April, which will help affected stakeholders to prepare.

The government has already committed to providing a digital tool to help engagers decide whether they need to apply the rules and pay employment taxes and NIC, and has engaged with stakeholders on the detail of the tool design. HMRC is grateful to respondents for detailed comments on the questions for the new tool. The government will continue to work with stakeholders over the coming months to develop the design and content of the new tool to ensure it is ready for April.245

As noted, the Government announced that, in the light of the responses it had, it would remove the 5% allowance would be removed for contractors in the public service:

Respondents said that while in theory accounting for the 5% allowance would be mathematically simple, to account for it in payroll software would require an update which would be costly and time-consuming. Most organisations, particularly those in the public sector, said that accounting for the allowance would be ‘bureaucratic and expensive’ and to keep it was ‘illogical’ and

244 Off-payroll working … summary of responses, December 2016 pp5-6
245 op.cit. p6
complex, particularly as they could not understand the rationale for retaining it.

A small minority, mostly contractors and their representative bodies, said the allowance should be retained, with one suggesting that it should be increased as expenses sometimes exceed 5%.

**Government response**: As there was a strong call from many respondents to remove the 5% allowance the government has decided to remove it for PSCs with engagements in the public sector only. This will make calculating deductions of tax and NICs simpler and less burdensome for engagers and reflects the fact that PSCs will no longer bear the administrative burden of deciding whether the rules apply.

The government recognises that some currently compliant contractors will experience a reduction in take-home pay as a result of the withdrawal of the 5% tax-free allowance. PSCs will, however, still be able to claim allowable business expenses and those available to employees.246

Initially the Government had proposed that public sector bodies would use a two-part ‘gateway’ process to determine when IR35 applied: first answering a series of questions based on employment status case law about the nature of the individual contract to see if it was potentially in the scope of the intermediaries legislation, and then, if so, to use HMRC’s digital tool to provide a definitive answer.

However, in the light of the responses it had received, it confirmed that engagers and agencies would be able to rely on the digital tool alone:

Following representations, the government has decided not to introduce the separate gateway tests outlined in the consultation document.

The government agrees that the proposed gateway tests only work as designed if the person using them already understands employment status case law – and that most people would still need to go on to carry out the full test. Instead, engagers and agencies will be able to use the online tool alone, providing simplicity and certainty from day one of the contract.

As the government is involving customers in the design of the tool, it is confident it will enable public sector engagers and agencies to accurately determine at the start of a contract whether the rules apply in the majority of cases, reducing the risk of making an incorrect decision. The questions in the tool will be based on case law and HMRC will provide clear and simple guidance explaining technical terms, how the questions might apply and what to do if the circumstances of the contract change. The tool will be updated to reflect any new case law.

In a very small number of exceptional cases where the tool cannot provide a definitive answer, guidance and support will be available from HMRC as it is now. The government is grateful to respondents for their input to the digital questions. The government is working with a specialist digital team to develop the tool, and in collaboration with stakeholders to develop the content and design.247

246  *op. cit.* p10
247  *op. cit.* pp11-12
Just prior to the 2017 Budget, HMRC launched its digital tool – Check Employment Status for Tax (‘CEST’) – to guide organisations and freelancers on the potential application of IR35, and more generally, on determining employment status for tax purposes.  

Although the Chancellor did not mention IR35 in his Budget speech, the Government confirmed it would proceed with these reforms:

1.9. Off-payroll working in the public sector
As announced at Budget 2016 and confirmed at Autumn Statement 2016, the government will legislate in Finance Bill 2017 to reform the off-payroll rules and improve compliance in the public sector. Responsibility for operating the off-payroll working rules, and deducting any tax and NICs due, will move to the public sector body, agency or other third party paying an individual’s personal service company. The change will come into effect from 6 April 2017 and apply across the UK.

As a result of feedback received during the technical consultation, it will be optional for the agency or public sector body to take account of the worker’s expenses when calculating the tax due. This change would put these workers in the same position as other employees, whose employers can choose whether or not to reimburse the expenses they incur. This will not affect the individual’s right to claim tax relief on legitimate employment expenses from HMRC. The application of the rules to Parliament and Statutory Auditors will also be clarified.

An updated TIIN for this measure was published on 8 March 2017.

HMRC’s updated tax information & impact note summarised how the new rules would work …

Detailed proposal
Operative date This measure will have effect for contracts entered into, or payments made, on or after 6 April 2017.


Proposed revisions Legislation will be introduced in Finance Bill 2017 to include a new Chapter in ITEPA 2003 and relevant NICs regulations, so that where an individual works for the public sector, through their own PSC and falls within the rules:

- the public sector engager or agency is treated as an employer for the purposes of taxes and Class 1 NICs
- the amount paid to the worker’s intermediary for the worker’s services is deemed to be a payment of employment income, or of earnings for Class 1 NICs for that worker
- the public sector engager or the agency is liable for secondary Class 1 NICs and must deduct tax and NICs from the payments they make to the intermediary in respect of the services of the worker

HMRC, Check employment status for tax – guidance, March 2017
HM Treasury, Overview of Tax Legislation & Rates, March 2017 para 1.9
the public sector is defined using the definitions in the Freedom of Information Act 2000 and the Freedom of Information (Scotland) Acts

the person deemed to be the employer for tax purposes is obliged to remit payments to HMRC and to send HMRC information about the payments using Real Time Information.

… and gave some details of the anticipated impact for both individuals and public sector organisations:

This measure is expected to impact on public sector organisations who engage off-payroll workers and agencies supplying workers to the public sector … Where the intermediaries legislation applies the engager or agency will be responsible for deducting tax and NICs payments from payments made to the PSC and remitting them to HMRC. There will be a consequential impact on public sector organisations, who will now have to consider whether the intermediaries legislation applies to their workers.

Affected businesses will incur one-off costs for familiarisation with the new rules and putting in place processes to share information between procurement and payroll sections. Ongoing costs for accounting and reporting through Real Time Information and using the digital tool are expected to be negligible …

The government estimates that this measure will also affect around 30,000 PSCs. Administrative costs currently incurred by compliant PSCs in calculating tax and National Insurance will now move from the PSC to the public sector organisation or the agency supplying the worker to the public sector.

Small and micro business assessment: smaller agencies may be disproportionately affected by familiarisation costs if they provide workers to the public sector. The measure will require them to place the employee on a payroll. These costs to smaller agencies may be significant however there are also likely to be overall savings for affected PSCs of £300,000 per annum.250

At this time HMRC estimated that, taken together, these changes will raise £205m in 2017/18, falling significantly to £120m in 2018/19, before rising in subsequent years, to £210m by 2021/22.251

As noted, there was relatively little comment on this reform in the House, though it was raised in four linked PQs just before the Budget:

Asked by Tulip Siddiq: To ask Mr Chancellor of the Exchequer, what assessment he has made of the effect of planned changes to the IR35 tax system on the number of agency workers employed by the NHS.

Answered by: Jane Ellison: The Government does not have an estimate for the effect of the changes to off-payroll working (IR35) on the number of agency workers in the NHS. The changes apply equally to those engaged directly, and those engaged through an agency. These changes do not introduce any new tax or national insurance liabilities. Those compliant with the current rules should receive broadly the same pay after deductions for tax and national insurance contributions that they do now.

250 Off-payroll working in the public sector: changes to the intermediaries legislation, 8 March 2017

251 Spring Budget 2017, HC 1025, March 2017 pp 28-9 (Table 2.2 – item v & item ao)
The Government has consulted widely since the changes were announced at Budget 2016. HM Revenue and Customs arranged specific events to support the healthcare sector to understand and plan for these changes. Both NHS executives and other health professionals have taken part in the government’s consultation events. The Government has no current plans to extend these changes to the private sector, but keeps all taxes under review.  

Writing in *Taxation* magazine earlier this year, one practitioner suggested that the new regime was “likely to result in individuals … finding that they should have dealt with their tax computations under IR35” as despite the rules having been in place since 2000, “there is still a lot of ignorance about when it applies … I expect the results of this change to lead the Revenue to recover significant sums due to the misunderstanding of the historical rules.”

### 6.4 Finance Bill 2017

Provision to this effect was included in the *Finance Bill 2017* published on 20 March (specifically, clause 7 and schedule 1 of the Bill). Following the Prime Minister’s announcement, on 18 April, of the Government’s intention to call a General Election on 8 June, the House completed all of the remaining stages of the Bill in the Commons on a single day, 25 April, and the Finance Act 2017 received Royal Assent on 27 April. With cross-party support the Government removed a series of clauses from the Bill, with the intention of legislating for these at the start of the new Parliament, but this part of the Bill was retained – and now forms s6 & schedule 1 of the Act.

On this occasion Treasury Minister Jane Ellison reiterated the Government’s case for the reform, and announced one minor, amendment to these provisions:

Clause 7 and schedule 1 reform the off-payroll working rules—also known as the intermediaries legislation, or IR35—for individuals working in the public sector … The off-payroll working rules are designed to ensure that where individuals work in a similar way to employees, they pay broadly the same taxes as employees. However, non-compliance with these rules is widespread, and Her Majesty’s Revenue and Customs estimates that less than 10% of those who should operate these rules actually do so. As a result, more than £700 million is lost each year across the economy, of which about 20% relates to non-compliance in the public sector. This is neither sustainable nor fair, and we believe that public authorities, in particular, have a responsibility to taxpayers to ensure that the people working for them are paying the right amount of tax …

The changes being made by clause 7 and schedule 1 … move responsibility for determining whether or not the off-payroll working rules apply, shifting it to the public authority that the individual is working for, from 6 April 2017. They also make the public authority, agency or other third party that pays the individual’s company responsible for operating PAYE on those

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252 PQ65593-6, 7 March 2017

payments. This will improve compliance with the rules, raising £190 million a year by 2021/22. It is important to note that the reform does not introduce a new tax liability, nor does it affect the genuinely self-employed; the change will simply ensure that the current rules are applied as intended.

To provide certainty and clarity where it is needed, HMRC has worked extensively with stakeholders to develop the new digital “Check employment status for tax service”, which public authorities can use to help implement the changes. That service has been live since last month, and it has now been used many thousands of times—more than 273,000 times—to assist people in applying the off-payroll rules ... Government amendment 10 is a technical one to ensure that the reform only applies to the public sector, as set out in the Government’s original announcement.254

As with the Bill as a whole, the clause and schedule, as amended, was agreed without a vote.

Eighteen months later, following a consultation exercise the Government confirmed in the 2018 Budget that this reform would be extended to the private sector from April 2020. In this context there has been a lot of interest in the impacts of the public sector reform. This is discussed in more detail below, but two points are worth making here.

First, in answer to PQs in July 2019, Treasury Minister Jesse Norman has said, “the Government has monitored the public sector reform of the off-payroll working rules through independent research, engagement with the public sector and analysis of HMRC data” and that, “evidence shows the changes are having the desired effect. Compliance is increasing, with an estimated £550 million in additional employment taxes being raised over the first 12 months without damaging the flexibility of the labour market.”255

Second, at this time Treasury Minister Elizabeth Truss announced that in the light of the public sector reform, the 2012 Treasury rules regarding off-payroll engagements by government departments were no longer necessary:

Elizabeth Truss (The Chief Secretary to the Treasury)
HCWS1774 Off-payroll Engagements

In 2012, HM Treasury implemented a set of rules which required departments’ most senior staff to be on payroll, and to seek assurance in relation to the tax arrangements of their long-term, high-paid contractors who are off-payroll.

Reforms to IR35 off-payroll working rules in April 2017 require public bodies to deduct tax and NICs if the off-payroll worker works like an employee, compliance of which is monitored by HMRC.

Following a review of the rules, I have concluded that the off-payroll rules implemented in 2012 are now superseded by the IR35 reforms, and the requirement for departments to include set

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255 PQs269110-4, 3 July 2019
contractual provisions and conduct an assurance process are no longer necessary.

However, it remains essential that board-level appointments and/or those with significant financial responsibility should be on the payroll of the department or other employing body, unless there are genuine exceptional circumstances that do not exceed 6 months. The HMT off-payroll rules have been amended to reflect the outcome of this review, and updated guidance has been published on the government website.


This guidance includes increased transparency requirements, whereby the duration of off-payroll engagements of board members and/or senior officials with significant financial responsibility is to be reported in departments’ annual accounts in future reporting cycles. This will replace the need for annual reviews.256

256 Written Statement HCWS1774, 22 July 2019
7. PSCs, IR35 and BBC presenters (2018-19)

7.1 The ‘Ackroyd’ case (February 2018)

In February 2018 there was widespread press coverage of the outcome of an appeal against an IR35 assessment by HMRC. In 2001 the BBC engaged Christa Ackroyd as presenter of its Look North news programme, and over the next twelve years Ms Ackroyd provided her services through a PSC. In 2013-14 HMRC issued decision notices seeking over £400,000 in unpaid tax, on the grounds that Ms Ackroyd’s PSC should have applied IR35. Her company appealed, but the tribunal upheld HMRC’s assessment.

It appears that Ms Ackroyd had initially decided to use a PSC because the BBC had suggested she do so. As the tribunal observed, “the BBC did not want Ms Ackroyd to be an employee and we also infer that they did not want any potential liability for PAYE and national insurance if she were to be classified as an employee.” The tribunal found that the BBC had fired Ms Ackroyd in 2013, following the review it had undertaken of its off-payroll contracts the year before, and HMRC’s first determinations that IR35 should have been applied in her own case:

Ms Ackroyd considered that the BBC’s attitude towards her changed from the beginning of 2013. This followed evidence from the BBC given to the House of 25 Commons Public Accounts Committee in July 2012 and the publication of a review undertaken by Deloitte on behalf of the BBC into freelance engagements at the BBC. We know that the review was published on 7 November 2012. The review recognised that the BBC required a large number of freelancers to make its programmes and referred to the BBC’s policy of engaging a small number of “on air” individuals via 30 personal service companies.

As a result of the review the BBC changed the way it viewed personal service companies. It no longer intended to engage on air talent with long term contracts through personal service companies. The BBC anticipated that a number of such individuals would be offered employment contracts when their current contracts expired. No employment contract was ever offered to Ms Ackroyd.

There was a meeting between Ms Ackroyd and [Helen Thomas of the BBC] on 21 February 2013 where the HMRC investigation was discussed. On 4 March 2013, following a conversation, Helen Thomas wrote to Ms Ackroyd to say that she was being withdrawn from her presenting duties with immediate effect …

Shortly thereafter Ms Ackroyd herself became a news story. We were told that there were newspaper stories about her being a “tax cheat”, although we were not taken to any specific stories. We stress that HMRC have never suggested that is the case, or that Ms Ackroyd has ever acted in any way dishonestly.

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257 eg, “HMRC wins tax case against BBC presenter”, Guardian, 15 February 2018
258 Christa Ackroyd Media Ltd v HMRC [2018] UKFTT 69 para 24
259 op.cit. paras 121-3
There was quite a lot of commentary on the tribunal’s assessment that IR35 applied.260 In part one suspects that this is because it appears that as many as 100 similar actions are being taken by HMRC against TV presenters,261 although the tribunal noted that this was “not a lead case as such.” In its judgement the tribunal underlined the basic point that in determining employment status “it is not appropriate to adopt a mechanistic or ‘check list’ approach [and] … each case must be determined on its own facts”:

Standing back and making an overall qualitative assessment of the circumstances we consider that Ms Ackroyd was an employee under the hypothetical contract. If the services provided by Ms Ackroyd were provided under a contract directly between the BBC and Ms Ackroyd, then Ms Ackroyd would be regarded for income tax purposes as an employee of the BBC.

We acknowledge that this is a value judgement. It is in the nature of a value judgement that different people may come to different conclusions. We do not criticise Ms Ackroyd for not realising that the IR35 legislation was engaged. She took professional advice in relation to the contractual arrangements with the BBC and she was encouraged by the BBC to contract through a personal service company.262

Arguably the significance of the case lay not in the failure of Ms Ackroyd’s PSC to apply IR35, but the role of the BBC encouraging presenters to use PSCs. As the Financial Times reported, the tribunal’s judgement underlined that Ms Ackroyd was not guilty of any wrong doing and had “raised uncomfortable questions for the BBC over why it encouraged Ms Ackroyd and others to go ‘off payroll’, a move that MPs have already criticised as ‘staggeringly inappropriate’.”263

Writing in Taxation, the magazine’s editor Andrew Hubbard underlined his concerns as to the relative position of parties when it came to this type of dispute: “There was a specific finding of fact that it was the BBC that suggested Ms Ackroyd should work through a PSC. But the BBC was not party to the appeal … Should engagers be able to wash their hands of a problem by saying ‘it’s nothing to do with me’?”264

On his blog tax barrister Jolyon Maugham noted that this result was as a consequence of the Labour Government’s decision when it introduced IR35 that the tax liability should lie with the PSC:

The drafters of the IR35 regime intended that, if IR35 applied, the tax liability should sit with the engager (here the BBC). That made sense for several reasons: the engager were beneficiaries of the use of personal service companies (they avoided liability to employers’ NICs) and the tax can be collected from the engagers (in practice, very often it can’t be from PSCs).

260 See, for example, three articles in Taxation: “A weird world”, 1 March 2018; “Brave new world”, 29 March 2018; “Serve and obey”, 12 April 2018. See also, “Rough justice”, Accountancy, June 2018
262 Christa Ackroyd Media Ltd v HMRC [2018] UKFTT 69 para 5, paras 179-80
263 “BBC’s payroll policy under scrutiny”, Financial Times, 16 February 2018
264 “Tax system must be seen to be evenhanded”, Taxation, 22 February 2018
But the Government of the time gave in to lobbying from engagers. And the result was the unfortunate situation we now see, where historic liabilities are shuffled onto those with the least knowledge and often without the resources to meet them.  

7.2 The DCMS inquiry into BBC pay (March 2018)

Jolyon Maugham was one of the witnesses who gave evidence to the Digital, Culture, Media and Sport Committee on 20 March 2018, when the Committee looked at this issue and the related question of the BBC’s application of the public service rules for IR35, as part of a wider inquiry on BBC pay. The sessions provided a lot of information both about the BBC’s own practice in engaging PSCs, and the practical problems arising from the operation of IR35, and are quoted at length in this section.

The Committee had received a large amount of evidence from individual presenters which it published the day before the session, and on the same day the BBC announced its response to calls that it should consider compensating freelancers who had worked for the corporation using a PSC and might now face assessments from HMRC for having failed to apply IR35:

We intend to set up a fair and independent process under the supervision of the Centre for Effective Dispute Resolution (CEDR) to determine the right approach in cases where on-air presenters believe the BBC bears some liability in relation to demands for Employers’ National Insurance Contributions.

We have agreed with the Comptroller and Auditor General of the National Audit Office that we will keep him fully informed as this review progresses, and facilitate any audit or assurance work he may require.

Separately, as HMRC’s approach to taxation in the media has evolved over time, the BBC will invite broadcasters to consider together an industry-wide approach.

In its press notice the corporation also confirmed that application of the public service reform had seen a larger number of presenters being covered by IR35:

In 2017, the Government introduced new rules relating to the tax accountability for payments to intermediaries in the public sector. Alongside it, HMRC introduced new guidance (the Check Employment Status for Tax - the CEST) which continues to be revised and updated in relation to its application to the production and broadcast industry. These changes have led to a number of new questions and issues arising in relation to the assessment of tax status across the industry, as the new guidance indicates that a larger proportion of on-air presenters should be treated as employed for tax purposes than previously.

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265 “The BBC, presenters and HMRC”, Waiting for Godot blog, 4 March 2018
266 For details see, DCMS Committee, BBC pay inquiry - BBC employees written evidence, PAY0010 & PAY0011, 19 March 2018
267 BBC press notice, BBC and personal service companies, 19 March 2018. The BBC also wrote to the Committee at this time: BBC pay inquiry – written evidence, PAY0012, 19 March 2018
At its session the DCMS Committee heard first from four broadcasters, including Money Box presenter Paul Lewis. Mr Lewis discussed the experience of colleagues about having to set up PSCs …

Can I say first … this is not the story of well-paid presenters trading through companies to avoid tax? This is the story of the BBC forcing … hundreds of presenters to form companies and treat them as freelancers, because that gave the BBC flexibility … It protected them because … in the words of the BBC, “Until last year it was the responsibility of the people who had formed a PSC to ensure they paid the correct tax.” …

The price was paid by presenters who were exposed to the risk that one day the HMRC would come to them and decide they were not freelances but were employed and claim back taxes, including employers’ National Insurance. That risk has become real for a small group of TV presenters in court next week, hundreds of others now fear the brown envelope and there are a hundred or so for whom that is already beginning …

Chair: A strong sense comes from the dossier that the Committee published yesterday of people feeling they were being compelled to do this even if they did not want to. Is that a fair reflection, in your view?

Paul Lewis: It is a reflection of how they felt. I think the BBC’s view—and I am sorry that I have to put it as they are not here—is that no one was forced, but they do feel that and the evidence is that if you did not do it you did not work. So that was being forced, in my view, and people certainly felt that they had no choice but to agree to form a PSC. 268

… and about the BBC’s response to the public service reform:

The BBC became liable from April last year under the new law that was passed and, since it took on that liability, it decided it would not take the risks that it had forced presenters to take for more than a decade. It decided that it would act to change people’s status. So probably end up under the present way of doing things 90%-odd will not trading through a PSC but employed for tax purposes, which is what the BBC like to call it. So PAYE is deducted at source before you see the money.

I have to say that it was done in such a cack-handed way that many people have been faced with financial difficulties such as double taxation, no pay, and threats of no work, and that has led to that dossier of despair, shall I call it, which was presented to you. It is sad to us that it took the publication of that to arouse the BBC to say what it was saying late last night about an inquiry. 269

He also talked about his personal experience with the corporation:

Chair: Mr Lewis, you declined to set up a Personal Service Company, is that correct?

Paul Lewis: It was more than declined. I said, a bit like the BBC’s ultimatum, that you either have one and you work or you do not have one and you don’t work. I just said I would not under any circumstances have one and I went to HMRC. My circumstances are a bit different, because most of my money does not come

268 Digital, Culture, Media and Sport Committee, Oral evidence: BBC Pay, HC 732, 20 March 2018 Q252, Q255
269 op.cit. Q252
from the BBC. I am a sole trader. I have multiple clients, 20 maybe this year, of which the BBC is one. I was in the position where I could go to HMRC, let them look at everything I did and at the time, in fact on two occasions, 2005 and 2012, HMRC agreed with the BBC that I should continue to be a freelance sole trader. I am rare but not unique.270

In her evidence broadcaster Liz Kershaw said that BBC staff had suggested that HMRC were keen that presenters should be providing their services through a PSC:

Chair: Were you coerced into signing documents, Liz Kershaw?

Liz Kershaw: Yes, I was initially … having been a BBC national presenter since 1987 and being registered as self-employed … at the end of 2009 I received a letter, which I have supplied to the Committee, which was very clear that I could not continue like that and that I would have to set up a company. You have several examples from my email exchanges.

I think it also demonstrates that the BBC was trying to claim in that email exchange with me that it was an HMRC stipulation. At the same time the BBC’s Chief Financial Officer, Zarin Patel, was blogging on the BBC website to staff—not us but staff—that it was HMRC, it was worked out with HMRC, the suggestion of putting people on Personal Service Contracts was HMRC-approved.271

In his evidence Jolyon Maugham was asked whether it was likely that HMRC would have actively encouraged the BBC to engage presenters through PSCs:

Never say never in this world but the notion that the BBC could have received a directive from HMRC to engage people through PSCs strikes me as being implausible to the point of impossible.

HMRC has no incentive to seek to secure that those who are self-employed are engaged through PSCs. If anything, HMRC has an incentive to secure that those who are self-employed are engaged directly and there are a number of reasons why that is so. In particular one of the reasons why the IR35 regime has failed is that it is impossible for HMRC in practice to collect any tax that is found to be due from PSCs. PSCs are very often poorly capitalised and if they face large tax demands just go under. That is certainly not true of the BBC.

It is also the case that if you are only looking at the situation of one engager of presenters rather than hearing the more than 3,000 engagers of presenters your job as the tax collecting authority is that much easier.272

Mr Maugham went on to describe the advantages to the BBC that presenters were engaged in this way …

There is a whole raft of advantages and you can categorise those broadly into two camps. There is the employment rights camp and then there is the tax camp. So looking at employment rights first, almost all situations where a PSC is interposed between a presenter on the one hand and her engager here, the BBC on the

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270 op.cit. Q253
271 op.cit. Q268
272 op.cit. Q317
other, will have as a consequence that the engager here, the BBC, no longer has an obligation to offer any type of employment rights or workers’ rights to reflect a worker’s desire for flexible working, as Ms Elliott was talking about earlier [see Qs264-5]. No employment rights at all are available to somebody where they are engaged through an intermediary. Those rights, including very valuable rights like pension rights, deliver to the BBC a very considerable cost saving …

Then there is a whole raft of other advantages that fall into the tax camp. Sometimes—it is technically possible—that you can just avoid a 13.8% liability to employers NICs by interposing a PSC.273

… while acknowledging the competitive pressures that the corporation are under in engaging staff:

Alongside that, if you, as the BBC, are facing competition from other broadcasters for the talent that you are seeking to engage, you have to take into account that PSCs can deliver the opportunity for tax planning to presenters … That creates a genuine difficulty for the BBC in circumstances where it addresses its mind to the question, is this person really self-employed. Either it pays more than ITV would pay and is accused in the media of overpaying for talent or it recognises that it has to compete with ITV and so it has to offer a PSC as well, then after the fact is accused by the media of facilitating tax avoidance. It is important to recognise that the BBC does have a genuinely difficult task here. That is not the same as saying the BBC always has it right. It certainly has not.274

Mr Maugham also described the potential tax advantages for presenters for working this way …

The interposition of a PSC gives the presenter the opportunity to embark on tax planning that can materially improve their post-tax income. It also very often leads to the presenter receiving a higher amount of money than they would have received had they been engaged in pre-tax terms. Very often the way these arrangements work is that the engager says, “Look, if you want to be on staff we will pay you £100, but if you want to go freelance we will pay you £140; that £40 representing the cost to us of delivering all of the employment right-type protections that you would be entitled to if you were our employee”.

Sometimes, and in some industries very often, the individual in question would much rather have the extra £40 and self-insure than they would have the benefit of the employment protections. Looking at it in purely contractual terms, and just leaving aside the legislative picture, that is the dynamic that predominates.275

… with the attendant risk of failing to apply IR35:

The fact of interposing a PSC does not create a tax problem. What creates a tax problem is interposing a PSC and then treating yourself as self-employed. The fact that the BBC insisted on PSCs being used here is not of itself what led to the difficulties that individuals now face. What led to those difficulties is the fact that they then treated themselves as self-employed. They could have taken all of the money that was paid to the PSC, paid themselves all of that money as employees and they would not

273  op.cit. Q318
274  op.cit. Q318
275  op.cit. Q319
now face any tax difficulty at all. It is that part of the equation that, with respect, the Select Committee should focus on, as well as the conduct of the BBC. 276

On the impact of public service reform Mr Maugham made two interesting points – first, on the BBC’s application of the new rules...

In two years’ time this Committee is going to be looking at a different question, which is whether the BBC and the NHS were right to force everybody to be taxed as employees in circumstances where the case law has shown after the fact that very often those people were properly taxed as self-employed.

What is happening now in the public sector in consequence of the changes that the Government announced in 2015, is that the NHS, Government Departments engaging IT contractors, the BBC, are all adopting very low risk approaches to those engaged on freelance contracts through PSCs … You heard evidence that individuals who are doing the status test and arriving at an inconclusive result are being told by the BBC that they have to be taxed under PAYE, even in circumstances where that result is, in some cases, just wrong. 277

… and second, on the inherent difficulties for HMRC in advising public sector organisations on the correct employment status of their staff:

The problem that HMRC faces is the employment status test is impossibly difficult even within an industry to derive to invent a status tool that applies to the construction industry, applies to IT contractors, applies to actors, applies to presenters, and applies to barristers is beyond the technology that we presently have available. These are difficult complex exercises ...

Parliament required that everyone who is a public sector engager of labour ask itself the question whether that labour is employed labour for tax purposes. What HMRC has tried to do is help the public sector engagers answer that very difficult question. What Parliament did in respect of public sector engagers in the second 2015 budget was require public sector engagers as a matter of law to do what morally, reputationally, they ought to have been doing anyway but had not been. 278

As an illustration of these difficulties, some weeks after the Ackroyd decision the tribunal considered a second case involving IR35, which HMRC lost. Writing in the Tax Journal, Liz Wilson (Squire Patton Boggs) wrote, “Following hot on the heels of HMRC’s win in the Christa Ackroyd Media v HMRC, last month, comes the almost identical MDCM Ltd v HMRC, [2018] UKFTT 147, a case which HMRC lost. It is difficult to discern any guiding principles of any use from these two cases, other than that there are few guiding principles of much use.” 279 On this issue, in answer to a PQ in October 2018, Treasury Minister Mel Stride confirmed that “In the last ten years HMRC has taken twelve IR35 cases to tribunal. They have lost in nine of the cases. The vast majority of the decisions on status are straightforward and do not involve litigation. It is

276 op.cit. Q322
277 op.cit. Q331
278 op.cit. Q332-3
right that HMRC litigates more finely balanced cases, particularly where they are complex or unusual.”

Following the session on 20 March the DCMS Committee wrote to the BBC with a series of questions in April, and in turn Andrew Scadding, Head of Corporate Affairs for the BBC, replied the following month. In their letter the Committee had asked if HMRC had actually instructed the BBC to engage presenters through PSCs:

6: A letter sent from BBC lawyers stated that "the BBC, in agreement with the Inland Revenue, now requires freelance radio presenters, when contracted on a long term freelance basis, to be contracted via a service company". Did HMRC require that the BBC use PSCs to contract with presenters? What advice did the BBC receive from HMRC on this matter?

The NAO will look at the relationship between the BBC and HMRC. However, the Committee should note that the specific email provided to the Committee was sent to the recipient in error in October 2010, and this was corrected within a couple of days, both orally and in writing to make it clear that the requirement to use PSCs was not a specific requirement of HMRC, but a BBC policy for freelance presenters.

This was acknowledged by the contributor to whom the email was originally sent at the time. We attach a copy of the email exchange for your information, and although the individual may be known to the Committee, we have redacted their name.

The BBC and HMRC have had continued dialogue since at least 2004, and it is clear that HMRC were well aware of the BBC’s policy of engaging on air talent on long terms contracts via PSCs, not least since the BBC provides HMRC with the details of talent engaged via PSCs as part of the yearly Statement of Annual Earning report.

7.3 Inquiries by the Public Accounts Committee and the NAO (2018-19)

At this time the issue also arose as part of two separate evidence sessions held by the Public Accounts Committee. First, on 25 April, the Committee took evidence from the BBC as part of an inquiry on their commercial activities. Opening the session Chair Meg Hillier, Committee Chair, asked about the corporation’s application of the new public sector rules, and in his response Director-General Lord Hall was critical about HMRC’s roll-out of its Check Employment Status for Tax (‘CEST’) tool, which, as noted above, allows organisations and freelancers to assess the potential application of IR35 to specific engagements:

What has taken place is a series of changes from HMRC, ending up in the last tax year with a new test for presenters and our front-of-camera and mainly front-of-microphone staff … when HMRC said that the test that it was applying, and was asking us
to apply, was not fit for purpose, so we need to work out yet another CEST, as it is called.282

HMRC’s then Permanent and Second Permanent Secretaries, Jon Thompson & Jim Harra, gave evidence to the Committee on 30 April.283 On this occasion, Meg Hillier, Committee Chair, mentioned the general concerns that had been expressed about CEST,284 and then went on to ask John Thompson if he accepted Lord Hall’s description of CEST as not fit for purpose:

Chair: Is that something you would agree with?

Jon Thompson: No.

Chair: Okay. Do you want to expand on that?

Jon Thompson: Sure. The check your employment status for tax tool is an online tool that has been used 750,000 times by citizens across the United Kingdom. Sixty per cent. of the outcome—those people—are self-employed and 40% are employed. We think it provides a reasonable guide. Remember, IR35 came in in 2000, under the Gordon Brown Budget of that year, when HMRC was still the Inland Revenue—hence IR35.

In relation to the taxpayer concerned—the BBC—I think that is a regrettable comment given that our customer compliance manager has been working with BBC for some time to ensure compliance in the BBC, and has been providing it with help and guidance. I have a fairly extensive note here about the amount of work we have been doing with BBC.

We believe that we have operated with a consistent approach to IR35, and indeed helped the BBC to clarify which people ought to be on a payroll and which people should not. I have been provided with how many additional people have gone on to the payroll—I am not sure that that is public information, but certainly a considerable number of people—so I would not agree with the Director-General, no.285

The DCMS Committee published its report on BBC pay in October 2018, and as part of this, was strong critical of its policy of engaging presenters through PSCs:

The imposition of personal service companies falls short of the standards that we expect from any responsible employer and especially from the BBC. The corporation should be held to high standards due to its prominence in public life and its public funding. Yet the BBC’s 2007–2012 policy of engaging presenters via PSCs has caused “life-altering” financial and emotional consequences for many presenters. The imposition was for purposes that suited the BBC, but not necessarily the interests of its employees. As a direct result of the corporation’s actions, many presenters are facing liabilities of hundreds of thousands of pounds in unpaid income tax and national insurance contributions. We have seen strong evidence that the BBC made

283 Public Accounts Committee, *HMRC’s performance: progress review - oral evidence*, HC 972, 30 April 2018
284 *op. cit.* Qs2, 4-5
285 *HMRC’s performance: progress review - oral evidence*, HC 972, 30 April 2018 Q1
presenters feel that a PSC was a mandatory condition of work. This is a disgrace.

The BBC’s decision to launch a process under the supervision of the Centre for Effective Dispute Resolution (CEDR) marks a welcome step forward. However, it is regrettable that it took presenters coming forward to this Committee to force the BBC into action. Once again, the BBC seems content to ignore a problem until it is brought into the public eye.

Many individuals who were previously employed via a PSC are now classed by the BBC as “employed for tax purposes”. The way that these contracts have been administered has left individuals with no certainty or consistency as to what their take home pay will be at the end of each month. This state of affairs cannot continue and the BBC must work with the presenters affected to find a satisfactory solution. Freelance presenters should be engaged as an employee if they are providing services to the BBC unless they are doing so genuinely as someone in business on their own account providing services to numbers of clients including the BBC.

As an employee they must then be afforded the rights and protections, including tax rules, that follow. In cases where it is clear that people were coerced into setting up a PSC in order to carry on working for the BBC, and face substantial claims for outstanding tax as a result, then the BBC should offer those individuals compensation for their losses.286

Over summer 2018 the National Audit Office reviewed the BBC’s engagement with PSCs, and published a report on this in November that year, concluding that, “the BBC has taken steps to help affected individuals, however issues remain unresolved and a number of possible outcomes may have future financial implications for the BBC.”287

Three extracts from this report are reproduced below: first, on the NAO’s findings about the BBC’s past approach to encouraging freelancers to work through PSCs:

**Between 2004 and 2013, the BBC developed policies for what contracting method could or should be used when hiring freelancers in on-air roles.** In the early 2000s, the BBC had no preference as to whether it engaged freelancers directly as sole-traders or indirectly through PSCs. It considered presenting roles to be self-employed, and therefore it did not deduct PAYE or employee’s national insurance contributions, or pay employer’s national insurance contributions.

However, when the BBC became uncertain about the employment status for tax purposes of, in particular, the BBC’s news presenters in 2004, following an HMRC review of 100 BBC cases, and its other television and radio presenters in 2008, after an HMRC review of the commercial radio industry in 2007. It then introduced policies requiring freelancers engaged in longer-term or higher-value presenter roles to be hired through PSCs. This reduced the risk for the BBC.

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286 DCMS Committee, BBC Annual Report and Accounts 2017/18: Equal pay at the BBC, HC 993, 25 October 2018 para 77-9
287 NAO press notice, Investigation into the BBC’s engagement with personal service companies, 15 November 2018
In response to a Committee of Public Accounts report in 2012, the BBC revised its policies. From November 2013, the BBC began to use a new test for assessing the employment status of freelance television presenters and radio news presenters, while continuing to use the radio industry guidelines for non-news radio presenters.\(^{288}\)

It developed this new test, with Deloitte and in liaison with HMRC. The BBC also adopted a new policy for freelance television and radio news presenters, under which it offered those it assessed as employed for tax purposes the option of one of two new on-air talent (OAT) employment contracts. According to the BBC, all its news presenters who had previously been engaged through PSCs moved onto an OAT employment contract. By March 2018, the BBC had 90 OAT contracts.\(^{289}\)

The report went on to discuss the practical difficulties that the BBC experienced in using HMRC’s CEST tool to determine employment status, following the change to the IR35 rules as they operated in the public sector …

Use of HMRC’s CEST tool generated a different employment status for tax purposes in many cases, compared to the BBC’s use of its own assessment test and HMRC guidance.

The BBC’s use of CEST initially produced an ‘unable to determine’ employment status result in almost half of 255 on-air cases assessed, which reduced to zero following discussions with, and more guidance from, HMRC. It was not until August 2017, following these discussions and guidance, that the BBC felt sufficiently confident to rely on CEST.

Between August 2017 and June 2018, the BBC assessed 663 on-air freelancers using CEST, 92% of whom received an ‘employed for tax purposes’ determination. This contrasts with the situation before April 2017 where the BBC had assessed the majority of on-air freelancers as self-employed, using either its own assessment test or the radio industry guidelines. For on-air roles, the BBC has continued to use the additional guidance it received from HMRC along with CEST.

According to HMRC, CEST is a live tool that it is committed to keeping under review. To improve guidance available to those working in the media industry, the BBC, alongside commercial media organisations, is currently working with HMRC on updating HMRC’s employment status manual.\(^{290}\)

… and the corporation’s actions to help those staff who HMRC had assessed as coming under IR35:

The BBC has taken steps to help affected individuals. By August 2018, the BBC paid bridging loans to three people, totalling £2,550, to enable them to overcome short-term cash-flow problems and has given a contribution towards additional book-keeping fees arising from the IR35 compliance changes to 33 people with PSCs, totalling almost £12,000.

In addition, in March 2018, the BBC announced its intention to set up an independent mediation process for cases where on-air

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\(^{288}\) The radio industry guidelines were published in 2008 after HMRC’s 2007 review of the commercial radio sector.

\(^{289}\) NAO, *Investigation into the BBC’s engagement with personal service companies*, HC 1677, 15 November 2018 p2

\(^{290}\) *op. cit.* p8
presenters, who were hired through PSCs, believe the BBC bears some responsibility in relation to HMRC demands for employers’ national insurance contributions relating to before April 2017. It has yet to finalise this process as it has approached HMRC to discuss the possibility of an alternative approach to resolving historical cases, which may potentially offer advantages over the mediation process.

Issues relating to the BBC’s relationship with its freelancers remain unresolved and may have financial implications for the BBC. In its Annual Report and Accounts 2017-18, the BBC recognised potential financial consequences as a result of issues surrounding freelancers’ employment status as a contingent liability. However, it did not recognise a provision for this matter because the process and outcome were uncertain. This uncertainty remains and could be affected by other possible actions taken by affected individuals.

By May 2018, the BBC estimated that some 800 presenters, nearly 300 of whom were hired through PSCs, warranted further review as they were at risk of being challenged by HMRC. This could involve tax arrears for the BBC and for the PSCs. According to HMRC, as at October 2018, there were about 100 open investigations into BBC-related PSCs. All of these concerned arrears of tax before the April 2017 changes. All open cases relate to tax years prior to 2017 and the vast majority of these were opened prior to the reform.

There have been a number of developments since the NAO published its report.

First, in January 2019 the DCMS Committee published the BBC’s response to its report, and in this, the corporation stated it was working with HMRC “to clarify employment status to minimise the uncertainty felt by those affected” and exploring the “options for resolution in cases where individuals believe the BBC bears some liability for Employers’ NICs.”

Second, the BBC gave evidence later the same month on this issue to the Public Accounts Committee. As part of this, Anne Bulford, deputy-director general, gave some details of the difficulties the corporation faced with the introduction of the public sector reforms ...

HMRC made it clear to us in the run-up to the implementation of the new CEST that it preferred CEST to the radio industry guidelines and that if we wanted to have confidence in the assessment, that is what we needed to do … We wrote to HMRC in August 2016 and said this was coming in too quickly, and that it would cause huge difficulty for us; it would be particularly difficult for us because it impacted us in this sector, and nobody else. They disregarded that, and we think that was wrong.

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291 A liability is a present obligation of an entity arising from past events, which is expected to result in an outflow of economic benefits for the entity. A contingent liability is a possible liability that may occur depending on the outcome of uncertain future events. A provision is a liability of uncertain timing or amount.


293 BBC’s response to the Committee’s Sixth Report of Session 2017-19, HC 1875, 23 January 2019 p18
… and its efforts to agree a settlement with HMRC to cover outstanding tax liabilities:

We are trying to achieve a settlement that provides certainty for everyone looking back at employment status and taking a different view. It is primarily about agreeing with the Revenue a financial settlement that means we do not all spend a huge amount of time arguing about who was right and who was wrong on employment status; we make a financial settlement to deal with that, which fits within our requirements to achieve value for money and the Revenue’s regulatory requirements to settle. Broadly, it means looking back and saying, “Okay, if these roles had a different employment status, what would be the tax liability associated with that?” without going through all the tribunal stuff.294

Third, on 4 March 2019 the Committee took evidence from HMRC on a number of issues, and on this occasion Jim Harra, then Second Permanent Secretary, gave HMRC’s view of the introduction of CEST and its dealings with the BBC in its engagement with freelancers …

It was about two months before go live, where, following the feedback we had received, we had the tool in a position where we were satisfied that it could go into a beta product with results that we could live with. We therefore said that if public sector bodies wished to start using the tool from that date in order to get ready, we would stand by the results that it gave. For the vast bulk of the public sector, that proved to be adequate. We backed that up with a lot of support for public sector bodies—including the BBC, as the NAO Report acknowledges—to make sure that they could use the tool effectively in their own areas of responsibility …

As the National Audit Office Report shows, we had concerns about the tax treatment of some BBC presenters for some considerable time before the 2017 changes came in—going right back to about 2004, when we started that engagement. The fact is that both the radio industry guidelines and the CEST tool will give the same result if you apply them correctly. From our point of view, although the tool was there to assist public sector bodies to make decisions, it did not alter the test in any way.295

… and the use of the CEST tool now by public sector bodies …

The average rate of response for “unable to determine” results is about 15% from CEST. Once we had engaged with the BBC, I believe that it got its response rate up to 100%, so it got a better response rate from that tool than some other public sector bodies. We engaged with all the bodies as they needed to make sure they had the support to apply the tool correctly. We obviously monitored the feedback on the use of the tool, and we are committed to making improvements to it over time to try to push the response rate that it gives up as high as possible. If the tool does not give you an answer, we have a set of guidance and other support routes available to bodies so they can work with us to get the answer that they need.296

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294 Public Accounts Committee, *Oral evidence: The BBC and personal service companies*, HC 1522, 30 January 2019 Qs88-9, Q143
296 *op.cit.* Q11
… as well as making some brief comments about its ongoing discussions with HMRC about a settlement:

I am not able to disclose the status of our discussions with the taxpayer, but I can say that in general we are open to reaching a settlement, provided that we collect the tax that is due under the law. It is convenient for us if we can reach a global settlement for a large group of taxpayers, in administrative terms, but it is essential that any settlement complies with our policy, set out in our litigation and settlement strategy, which requires that the correct amount of tax is paid in that settlement.297

7.4 The DCMS report on the BBC and PSCs (April 2019)

Following these evidence sessions the Committee published a report on this issue in April 2019.

The Committee criticised the BBC’s approach as having been “muddled and chaotic” and asked that the corporation provide details of how it was improving its arrangements for freelancers, as well as its settlement with HMRC for outstanding tax claims.298

The corporation provided a response to the report in June; two extracts are reproduced below – first on its plans for improve its management of freelancers …

In 2018 the BBC undertook a review of on-air roles with the assistance of PwC.299 Since that review the BBC has been using an on-air fee comparison tool, Tableau, for the engagement of presenter and contributor roles. The Tableau software enables the collation of all the underlying data we have recorded across 1,850 engagements over two years to ensure that pay is appropriate in respect of the specific roles to which it relates …

Following the PwC on-air review, the BBC also re-considered its processes and governance around on-air engagements … The BBC introduced certain approval points that, if met, require an engagement to be reviewed centrally at the On-Air Talent Approvals Group. This was reviewed in the NAO’s May 2019 report into managing the BBC’s pay-bill.300

The BBC has also carried out an employment status review of roles in Network News, the Nations, English Regions and Sport programming. Where the assessment of these roles has resulted in a Staff outcome, individuals in these roles have been mapped to the relevant Career Path Framework and individually consulted with before being moved over to the correct contract.

To increase consistency, the BBC is also introducing a Central Assessment Team which will be responsible for the consistent assessment of Employment Status for these individuals. All requests will be assessed using the appropriate frameworks such as the CEST or the latest HMRC guidance and records will be kept for each decision made. This team will work closely with other specialist teams within the BBC to ensure knowledge of the

297  op.cit. Q17
298  Public Accounts Committee, BBC and personal service companies, HC 1522, 5 April 2019 p3, pp5-6
299  PwC, BBC : On-air review, January 2018
300  NAO, Managing the BBC’s pay bill, HC 2142, 16 May 2019
business is kept current and relevant and will respond to changes in legislation or emerging case law to ensure the frameworks are updated.

... and second, on the state of play regarding its settlement with HMRC:

Given the complexities involved in this matter, and although progress is being made, the discussions are necessarily taking time. We will provide a further update once the process has come to a conclusion. In the meantime, the BBC has published the broad principles it intends to apply to the settlement process (see enclosed the BBC’s press statement of 25 March 2019).

While settlement discussions are continuing, it has been decided to put on hold the mediation process, which would consider individuals on a case-by-case basis, rather than run overlapping processes. In the event that the settlement discussions with HMRC are not successful, the BBC will revisit the position in respect of the mediation process. \(^{301}\)

\(^{301}\) BBC Response to Public Account Committee’s Ninetieth Report of Session 2017-19, 18 June 2019 pp1-2, pp3-4
8. IR35 and the private sector (2017-21)

8.1 Autumn Budget 2017

On 11 July 2017 Matthew Taylor published his review of modern working practices.\(^{302}\) Although the review did not discuss IR35 or make any specific proposals regarding tax, it suggested that the Government should “seek to examine ways in which the tax system might address the disparity between the level of tax applied to employed and self-employed labour.”\(^{303}\) The Government’s response to the review was published in February 2018.\(^{304}\) This included a series of consultations including one, notably, on possible reforms to the tests for employment status used for both tax and employment rights.\(^{305}\)

With the implementation of the public sector reforms for IR35, there was considerable speculation that the Government would extend the new duty for contractors’ clients to the private sector,\(^{306}\) including some mention of this issue in the House:

**Asked by Jeremy Quin:** To ask Mr Chancellor of the Exchequer, what assessment he has made of the effect on compliance of the recent reforms to off-payroll working in the public sector; and what recent assessment he has made of the level and effects of non-compliance relating to the recent reforms to off-payroll working in the private sector.

**Answered by: Mel Stride:** The off-payroll rules (commonly known as IR35) ensure that where an individual would be an employee if they were engaged directly rather than through their own company, they pay broadly the same taxes as employees. Since April 2017, public sector bodies have been responsible for deciding if these rules apply.

Early analysis of tax receipts between April and June shows that around 90,000 additional new engagements occurred in the public sector above the level that would normally be expected. This indicates more individuals are being taxed as employees since the reforms, and is consistent with the government’s expectations that the reforms would increase tax compliance in the public sector.

The cost of non-compliance in the private sector is continuing to increase: the latest estimate is that tax losses to the Exchequer will grow to £1.2 billion a year by 2022/23. This is part of the wider increasing cost of incorporation highlighted by the OBR in their 2017 Fiscal Risks Report.\(^{307}\)

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\(^{303}\) *Taylor Review*, July 2017 p73

\(^{304}\) BEIS, *Government response to the Taylor review of modern working practices*, February 2018

\(^{305}\) The consultation was launched in February 2018 and closed in June that year. No further details have been published to date. For more background see, *Employment status*, Commons Briefing paper CBP8045, 28 March 2018.

\(^{306}\) For example, “Treasury considers crackdown on bogus self-employment”, *Financial Times*, 29 October 2017

\(^{307}\) PQ109236, 26 October 2017
At this time the ‘IR35 Forum’ - a group of external stakeholders who meet regularly with HMRC to discuss the operation of this regime – met, when there was some discussion of how the new rules were working …

Some members said they had heard anecdotally that there had been high contractor attrition as a result of the reforms, leading to significant delays in public sector projects. HMRC has yet to see evidence of significant impact on contractor attrition rates or delays to projects.

Members were also concerned that some smaller public bodies have struggled to implement the reforms, with particular difficulties understanding the boundary between fully contracted out services and the provision of services.

HMRC recognised the concern that some smaller public bodies may not have the same level of awareness of the reform as central government departments, but has been working closely with organisations representing this customer group to cascade messages and raise awareness. Both these issues are also addressed in the online guidance.

… and possible future reforms:

Members asked if the recent reforms in the public sector would be extended to the private sector. HMRC explained that the current focus is on embedding the recent reform, and that it was not possible to comment on the plans of the new administration. However, we do of course want to see compliance improve in the private sector. 308

The then Chancellor Philip Hammond presented the Government’s first Autumn Budget on 22 November, and the Budget report confirmed that the Government would “carefully consult on how to tackle non-compliance in the private sector, drawing on the experience of the public sector reforms”:

3.7 Off-payroll working in the private sector – The government reformed the off-payroll working rules (known as IR35) for engagements in the public sector in April 2017.

Early indications are that public sector compliance is increasing as a result, and therefore a possible next step would be to extend the reforms to the private sector, to ensure individuals who effectively work as employees are taxed as employees even if they choose to structure their work through a company. It is right that the government take account of the needs of businesses and individuals who would implement any change.

Therefore the government will carefully consult on how to tackle non-compliance in the private sector, drawing on the experience of the public sector reforms, including through external research already commissioned by the government and due to be published in 2018. 309

Mr Hammond’s announcement was raised briefly in the context of the Treasury Committee’s inquiry into the Autumn Budget, when representatives from the three main professional bodies gave evidence

309  Autumn Budget 2017, HC 587, November 2017 p32. See also, HM Treasury, Overview of Tax Legislation & Rates, November 2017 para 1.15
on 5 December. Wes Streeting asked for views on how IR35 could be made a success in the private sector. Extracts from each witness’ answer are given below:

**Frank Haskew (Head of Tax Faculty, Institute of Chartered Accountants in England and Wales)**: First, this is an extremely difficult area and obviously extremely controversial ... The original IR35 rules, as the Government proposed, are now what we have in the public sector arena. That was then changed during the consultation process, which led to the IR35 rules. The obligations were switched effectively to the personal service company. It is quite interesting in a way that here we are, 17 years later, and we have effectively almost gone back to the original IR35 proposal ...

Shifting the burden to the end user will create major changes. We have obviously already seen that in the public sector. Our evidence is that a lot of contractors are certainly not looking to work in the public sector now. There is quite a lot of expertise there that is not going into the public sector. We also understand that a lot of public sector bodies are using umbrella companies, suggesting that the contractors who do work for them are using umbrella companies. That is a new dynamic that needs to be added in here. We also have the fact that things like real-time information work and other administrative PAYE burdens create a lot of difficulty for people ... If the Government want to do it, we need to take stock, first, of how it has worked properly in the public sector and how that then will be applied before we look to move it on to the private sector. It is a long process that needs proper consideration...

**Ray McCann (Deputy President, Chartered Institute of Taxation)**: We have a very long history in this country of individuals trying to take advantage of the fact that there is a structural difference between how tax is levied on the fruits of self-employment as opposed to employment. The latter is notoriously more heavily taxed across a range of different areas. While that structural inequality, if I can put it that way without being pejorative about it, exists to the extent that it does, it will inevitably attract those who will seek to try to put themselves in a position where they are taxed as a self-employed person or, in the context of the IR35-type approach, taxed as a company.

The Government have taken some steps in recent years to try to reduce that. Changes to dividend taxation last year help with that. IR35, as Frank mentioned, was brought in some years ago, but that legislation just has not worked properly. HMRC ended up with very long-running investigations into whether IR35 applies. That is not good. We also have a situation where there are thousands, perhaps tens of thousands, of contractors who have found overnight almost that the law has changed underneath them. What they thought of as a stable situation is suddenly up in the air. Having met a fair number of those individuals, though not hundreds, there does seem to be a consistency that, as far as they were concerned, they were doing what the law allowed. They have suddenly found themselves in an adverse situation. It seems to me that this is an area that cries out for a much more strategic review as regards how we tax labour.

There have been some efforts made in that respect, but it seems to be the case that we have reached a point where we have to question the various differences in how the rewards from effort are taxed. Some of them will inevitably need to remain, but it is questionable whether we need the extent of the divergence we
have at the moment in terms of the difference in taxation between the self-employed and the employed. That is in terms of both what is allowed against earnings and self-employed profits, and how those profits are taxed.

It is 15 years ago that I was in HMRC. I remember discussing with the Board at the time the huge shift from self-employed into corporates. In that particular year, 2003, something like 500,000 extra companies set up. Lots and lots of little small businesses were moving into companies, and the Revenue was getting a bit concerned about where it would find the extra resource to monitor all these new businesses, which of course would be derived from all the tax inspectors who, up to that point, had been dealing with self-employed trades and now had corporates on their hands. It is a major problem and it impacts significantly on National Insurance Contributions as well, where there is a very long history over the last 20 to 25 years of endless attempts to try to find the means of rewarding people in a way that does not attract national insurance, either at employer or employee level.

Andrew Courts (Member, Global Forum for Taxation, Association of Chartered Certified Accountants) : It is a bit early to bring in this consultation process because you have not had enough time to evaluate the part that came in on public service companies in April. We are only eight months afterwards. You need to get a full year round and review all those items before you move into consultation on the next stage, which is bringing in workers who are not in the public sector. You need to wait a bit longer.

In addition to that, as Mr McCann mentioned a minute ago, you have also brought in new charges on the taxation of individuals working through public service companies. That needs to be weighed up alongside what you are trying to do. Are you trying to force people into employment? There is lots of other employment legislation going through at the moment that is clarifying people as workers. Therefore, rather than just a consultation in this area again, you need to have, as Mr McCann mentioned a moment ago, a much bigger discussion on the taxation of workers full stop. That may even be the removal of National Insurance, which has been pushed around, because that is the area where people are trying to avoid tax.310

8.2 Off-payroll working in the private sector consultation (May 2018)

The Government finally launched its consultation on IR35 in the private sector on 13 May. Responses were invited by 10 August.311 The consultation paper stated that extending the public sector reform to the private sector was the Government’s lead option, though it recognized “that public authorities faced challenges in implementing the reform and that this is a concern for businesses and individuals working in the private sector”:

By transferring the liability to the public authority … [the public sector body] has a responsibility and incentive to ensure that the

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310 Budget Autumn 2017: Oral Evidence, HC 600, 5 December 2017 Qs239-40. Also, “Treasury ramps up the pressure on contractors’ tax”, Financial Times, 12 April 2018
311 HM Treasury press notice, Government to consult on tax avoidance in the private sector, 18 May 2018
rules are operated correctly. It also ensures they have the evidence and means to collect the information they need to make a decision about the employment status of the engagement in real time, allowing the right tax to be paid at the right time. In addition, where mistakes are identified and reasonable care has not been taken, the liability can be effectively enforced against the public authority or agency. This reduces the need for lengthy compliance activity against the PSC, which might not have the funds to pay any debts that are later found to be due.

The government considers extension of similar reform to the private sector to be the lead option which will effectively tackle non-compliance … [It] recognises that public authorities faced challenges in implementing the reform and that this is a concern for businesses and individuals working in the private sector. We would therefore like to explore whether the design of the reform and the implementation process could be improved.312

The paper noted that HMRC’s current estimate was that a third of PSCs were working in a way that should bring them into IR35, but “currently only 10% of this group actually determine they should be taxed in this way.” In addition HMRC anticipated that the cost of non-compliance will rise considerably, “from £700m in 2017/18 to £1.2bn in 2022/23 … as the number of people working through PSCs continues to grow.”313

Writing in Taxation, Stephen Baker and Chesney Archer (Grant Thornton) noted HMRC’s 10% estimate, which implied that 90% of PSCs were not complying with IR35:

It would be interesting to know more of the underlying reasons for this perceived non-compliance. HMRC offers a few in the document, including long time lags, perception of enquiries and the fragmentation of responsibilities in labour supply chains.

However, from recent IR35 case law, one could infer differently. In two recent First-tier Tribunal cases (MDCM (TC6444) and Jensal Software (TC6501)), HMRC lost the argument as to whether IR35 applied to the engagements in question.

What do these decisions tell us about how HMRC enforces IR35 in practice? Is the 90% non-compliance solely attributable to PSCs or are there other reasons? We must acknowledge that HMRC won before the First-tier Tribunal in Christa Ackroyd Media Ltd (TC6334) but, significantly, this was the first IR35 case brought to tribunal in seven years. Looking again at this 90% non-compliance statistic, one wonders why more IR35 cases are not successfully brought by HMRC.314

The consultation document gave details of HMRC’s assessment of the consequences of the public sector reform for tax compliance, and the outcome of an independent review HMRC commissioned on its impact for public sector organisations.315

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312 Off-payroll working in the private sector: consultation document, May 2018 paras 6.7-6.9
313 op.cit., para 2.6, para 2.2
314 “Change ahead?”, Taxation, 12 July 2018
315 see, Off payroll reform in the public sector: HMRC Research Report 487, May 2018
On compliance HMRC estimated the rise in the number of individuals being taxed under IR35 is “on course to increase overall Exchequer revenues by at least the level estimated at Spring Budget 2017”: 

**Effect on non-compliance**

HMRC has analysed PAYE data covering the first 10 months of the reform, from April 2017 to February 2018. This shows that in any given month since the reform was introduced, there are an estimated 58,000 extra individuals who are paying income tax and NICs undertaking work for a public authority above expected levels. PAYE for some of these individuals is operated by the public authority, for others it is operated by an agency or umbrella company (HMRC Employment Status Manual para 2930). The number of extra engagements from which PAYE has been remitted has been broadly stable in each month since the reform was introduced.

This increase in PAYE employment is also reflected in an increase in tax receipts. HMRC estimates that an additional £410 million of income tax and NICs has been remitted from these engagements, since the public sector reform was introduced. This means that, taking into account the corresponding impacts on corporation and dividend tax receipts, the reform is on course to increase overall Exchequer revenues by at least the level estimated at Spring Budget 2017.\(^{316}\)

Research commissioned by HMRC to assess the impact on public authorities found that many organisations had difficulties applying the rules to start with, although “almost all public authorities surveyed are now confident that they are complying with the reform”: 

**Independent Research and Evaluation**

IFF Research and Frontier Economics were commissioned by HMRC to gather evidence on the experiences of public authorities in implementing the reform. The research looked at the key sectors of Public Administration & Defence, Education and Health & Social Work, and considered implications for employment, costs incurred and any process changes required.

The research consisted of a quantitative survey of 117 central bodies,\(^{317}\) (covering 4,095 sites) and 100 individual sites in the public sector, all of which had recent engagement with off-payroll workers. There were qualitative follow-up interviews with 30 respondents whose responses indicated they had been affected by the reform.

Overall the external research highlights that some public authorities experienced initial problems in implementing the reform. Some were unfamiliar with the legislation and guidance, but almost all public authorities surveyed are now confident that they are complying with the reform (97% of central bodies and 90% of sites surveyed were confident they were complying with the reform by August 2017). 

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\(^{316}\) *Off-payroll working in the private sector*, May 2018 para 4.4-5

\(^{317}\) The term ‘central bodies’ refers to organisations who deal with the administration of the public sector reform for more than one site. For instance, an NHS trust could be responsible for managing the public sector reform across a number of different hospitals and practices. Research findings for central bodies are reported separately from individual sites that are only responsible for the administration of the public sector reform at their own site.
Half of public authorities report they found the public sector reform easy to comply with (central bodies: 49%, sites: 57%). Of those who found the reform easy to comply with, the most common reasons were that they had the right systems in place and HMRC’s CEST service allowed them to make quick and easy assessments.

However, a considerable proportion of public authorities did experience early difficulties in complying with the reform. Public authorities who found the reform difficult to implement most commonly attributed this to familiarisation with the legislation and HMRC’s CEST service, although it was found that the functionality of CEST had improved for public authorities over time.318

This research also looked at two concerns raised by stakeholders as to the potential impact of this reform: first, that public sector clients would apply IR35 in a blanket fashion …

One of the concerns about the reform raised by stakeholders has been that public authorities were being overly cautious or judging more contractors as within the rules than they should be. The research did find that this could be a risk for a very small percentage of public authorities.319 However, the vast majority of public authorities were reported to be making assessments on a case-by-case basis (91% of central bodies and 87% of sites were making assessments on a case by case basis).320

… and second, that the public sector would face difficulties attracting sufficient numbers of staff:

Others raised concerns about the impact the reform might have on the ability of public authorities to recruit the required number and skills of contractors and that, to do so, rates for off-payroll workers would need to be increased.

The research did find that some public authorities have found it harder to fill off-payroll vacancies since the reform was introduced (32% of central bodies and 22% of sites). This was particularly where there had been pre-existing challenges with recruitment. Similarly, some public authorities reported off-payroll worker rates had increased since April 2017 (28% of central bodies and 20% of sites). However, this was found in areas where skills were already known to be scarce.

However, the research found that for most public authorities neither their ability to fill off-payroll worker vacancies, or the rates they pay them had changed since April 2017 (58% of central bodies and 70% of sites reported no change in the ability to fill vacancies; 63% of central bodies and 78% of sites experienced no change to contractor rates).321

It is worth adding that industry surveys published by the Association of Professional Staffing Companies (APSCo) in October 2017, and by the company Harvey Nash Recruitment Solutions in April 2018, found that a

318 Off-payroll working in the private sector, May 2018 pars 4.12-4.17
319 The research found that a small minority made determinations without conducting assessments. Qualitative interviews found that where public authorities had determined contracts to fall within the off-payroll working rules in the public sector without conducting assessments, it had typically been done for very short-term engagements (e.g. one-off services).
320 Off-payroll working in the private sector, May 2018 para 4.19
321 op. cit., paras 4.20-4.22
sizeable proportion of respondents reporting a rise in the rates charged by contractors.\footnote{APSCo press notice, \textit{Public sector bearing brunt of new tax rules}, 5 October 2017; Harvey Nash Recruitment Solutions press notice, \textit{IR35 Highly Destructive To Public And Private Sectors}, 19 April 2018} In their response to the consultation, the Institute of Chartered Accountants argued, “It is too early to assess the success or otherwise of the public sector off-payrolling changes”:

There has not yet been a full year’s cycle of compliance; PSC accounts and corporation tax computations and workers’ self-assessment tax returns are not yet due for submission and HMRC has yet to issue workers’ end-of-year tax calculations. This is work in progress affecting many workers who may not have chosen to work through a PSC of their own volition. It is therefore very important that the system supporting this change is reliable and that those using it can do so with confidence.\footnote{ICAEW, \textit{Off-payroll working in the public and private sectors: representation 91/18}, 26 July 2018}

One further impact of public sector reform has been to mitigate some of the difficulties HMRC face in tackling non-compliance.

The consultation paper noted that in the private sector HMRC needs to deal with each PSC individually “even where there are numerous workers engaged and working in the same way for a single client … A typical successful compliance case of this kind can take around 18 months from start to finish.” Apparently, for many off-payroll engagements, “there is the perception that there is very limited chance of enquiries being opened … [and] a prevailing feeling that the risk of being found to be non-compliant is low.”\footnote{\textit{Off-payroll working in the private sector}, May 2018 para 5.3, paras 5.5-6} Enquiries can be lengthy and complicated, as HMRC face practical difficulties in collecting information due to “long time lags between when an engagement takes place and when tax on the income arising from it is due”, and to the fact that responsibilities within a labour supply chain are often fragmented: “for example, in many supply chains, different parties have the responsibility for how the work is carried out, how work is supplied, and for ensuring the correct tax is paid, meaning HMRC has to interact with multiple parties within the supply chain.”\footnote{\textit{op.cit.}, para 5.9-5.10}

Finally it can also be difficult to recover tax that HMRC has found is due, as “the PSC will often no longer have the means to pay liabilities, especially given that a substantial amount of time is likely to have passed since the worker actually performed the work.”\footnote{\textit{op.cit.}, para 5.11}

However, in the public sector HMRC has found that “the numbers of interventions required to reach the same number of PSCs are now significantly reduced. HMRC is now able to approach a client in order to obtain information on a large number of PSCs at once. Where necessary, HMRC can open a single enquiry covering multiple off-payroll workers engaged by that client, greatly improving the efficiency of the compliance process.”\footnote{\textit{op.cit.}, para 4.7}
Apart from rolling out public sector reform to the private sector, the consultation mentioned some other options – such as encouraging or requiring businesses to ensure their contractors were complying with IR35, or requiring businesses to retain detailed information on contracts with PSCs to facilitate any HMRC enquiry. In previous consultations a number of alternative reforms have been proposed, but it was made clear that these were out of scope of this exercise. These alternatives have included excluding any PSC from IR35 for short-term contracts; requiring clients to pay employer NICs in certain circumstances; and, to impose a flat-rate withholding tax on contracts that would either be set against a PSC’s liability if IR35 applied or refunded.

Finally the consultation asked for views on whether the rules for the public sector should be amended:

For example, HMRC has found that some agencies have disregarded the public authority’s determination about the worker’s employment status and chosen not to operate PAYE. There may be valid reasons why the public sector rules do not apply, as the fee-payer is required to consider other criteria other than the employment status of the worker. However, the agency should not disregard the employment status determination made by the public authority. An incorrect decision that the rules should not apply could represent a failure by the agency to operate PAYE. HMRC could, having fully explored the reasons, look to use its powers to recover the tax due through compliance activity.328

The initial consensus among commentators was that any changes were unlikely to be made before April 2020. The consultation stated that this was the first stage in the five-stage process normally used in developing tax policy, so the Government had not made any decision as to what the best option to improve compliance might be.329

In a short article at this time Andrew Hubbard, editor of Taxation, observed “the document does not commit to a timescale and seems to me to ask the right questions, so there is hope that any change will be carried out collaboratively and within a sensible timeframe.”330 Mr Hubbard went on to note that “if the changes go ahead in anything like the form suggested they could have an enormous impact.” He also mentioned that the IFF Research & Frontier Economics report commissioned by HMRC: its “main findings were reasonably positive, which is surprising given the number of conversations I have had with experts in this area who continue to report major problems.”

Writing in the Tax Journal, Ian Hyde and Chris Thomas (Pinsent Masons) suggested that “it seems likely that the main proposal will go ahead”:

The system has already been rolled out to the public sector and HMRC could argue that PSCs have had their chance and failed to apply the existing rules properly. From the government’s perspective, this change in itself does not prevent genuine

328  op.cit., para 6.10
329  The Treasury has a Tax Consultation Framework that sets five stages to tax policy development. For details see, HMT, Tax consultation framework, March 2011.
330  “This week: change ahead for IR35 in the private sector?”, Taxation, 24 May 2018. See also, “UK in new crackdown on tax avoidance by contractors”, Financial Times, 18 May 2018.
contractors from using PSCs. When the contractor is not
genuinely self-employed then using a PSC can be seen as tax
avoidance and the public attitude to this has shifted considerably
since 1999. There is also a lot of momentum coming from the
wider Taylor review.\footnote{331}

The authors underlined that the Government was \textbf{not} proposing to
change the substantive law under IR35 as to whether an individual in a
PSC should be treated as an employee or how much tax is paid. “All
that HMRC proposes changing is who should pay the tax that arises”
but that, in their view, \textit{“rolling out the changes to the private
sector is totally different.”} The public authorities surveyed would
probably have had large payroll departments … [while] these changes
would apply to any business, no matter how small and how limited their
resources” \textit{(emphasis added)}. In this context it is worth underlining
that the consultation specifically asked stakeholders for their assessment
of size of the burden that this proposal would impose:

\begin{enumerate}
\item Q4. If the private sector rules were changed, do you have any
evidence that there are parts of the private sector where the
administration of any regime may need to vary even though the
basic principles including for determining status, remain the
same?
\item Q5. Is there any evidence that parts of the private sector will not
have, or be able to acquire the administrative capacity, knowledge
and resources to enable them to implement any changes in
relation to off-payroll workers?
\item Q6. How could these difficulties be mitigated?\footnote{332}
\end{enumerate}

Ian Hyde and Chris Thomas also suggested that large corporates are
unlikely to want to assess whether IR35 applies on a case by case basis:
“a form of risk based approach might be necessary; for example, setting
up model form engagements and testing them through [HMRC’s online
CEST tool] … [but] CEST is controversial … even on HMRC’s numbers,
there are 15\% of cases where there isn’t a clear answer.”\footnote{333}

This figure came from HMRC’s consultation document, which discusses
the use that contractors and clients have made of CEST so far:

The CEST service was designed to strike a balance between
providing an answer in most cases, whilst being simple and
straightforward to use. It has been rigorously tested throughout
development in conjunction with HMRC lawyers against live and
settled cases and reflects employment status case law. It gives a
clear answer as to whether a user is employed or self-employed in
85\% of cases.

For the remainder, HMRC provides detailed guidance and the
specialist employment status helpline. The CEST service has been
used over 750,000 times. HMRC’s latest figures show that it gives
a self-employed outcome around 60\% of the time, and employed
around 40\% (based on February 2018 data).\footnote{334}

\begin{footnotes}
\item 331 \textit{“Off-payroll working in the private sector”}, \textit{Tax Journal}, 1 June 2018
\item 332 \textit{Off-payroll working in the private sector}, May 2018 p28.
\item 333 \textit{“Off-payroll working in the private sector”}, \textit{Tax Journal}, 1 June 2018; for further
comment see, \textit{“Sinner or scapegoat”}, \textit{Taxation}, 4 October 2018.
\item 334 \textit{Off-payroll working in the private sector}, May 2018 para 4.25
\end{footnotes}
The IFF Research & Frontier Economics report found that “43% of central bodies that found compliance difficult said the most common factor was having difficulties using CEST. Sites were most likely to attribute their difficulties to not being confident in their understanding of the legislation (39%).” That said, apparently “qualitative interviews indicated that difficulties associated with using CEST related to an early version of CEST, which was replaced with an improved version.”  

Writing in *Taxation* just prior to the consultation launch, Alastair Kendrick, an employment tax specialist formerly at HMRC, noted, “it is clear that [CEST] does fall short of what was originally proposed. But to provide a single tool that covers all the possible factors was really a pipe dream. It is an indicator and, if it is wrong, there should be a procedure to allow the contractor to appeal at the point of payment (not at year end) and, if that appeal is correct, for their earnings to be treated as outside IR35.”

The issue was raised when the Public Accounts Committee took evidence from HMRC’s then Permanent and Second Permanent Secretaries, Jon Thompson & Jim Harra on 30 April. Meg Hillier, Committee Chair, noted that there had been claims that CEST had provided the wrong assessment in some individual cases. An extract from these exchanges is reproduced below:

**Chair**… There is a website contract calculator, and they have found that the CEST calculator has made incorrect assessments by not applying IR35 in some cases. Does that ring true to you, or can you explain why people might come to the point of view that it is producing unreliable results?

**Jim Harra**: That company, I believe, has its own calculator to push. Our calculator has been designed to comply with the case law on establishing employment status. It has been extensively tested, using lawyers. The results that it gives are as good as the data that are input into it. We did a lot of work last year with public sector engagers to make sure that they used the tool effectively, so that it would give them the right answers. It is ultimately a guide, and there is further, more detailed guidance that people can turn to if it doesn’t help them, but we believe that in 85% of cases it gives a response that the engager can use and that we stand by. In the further 15% of cases, they do have to either look at further guidance or get assistance from us to arrive at their decision. While we continue to work on it and improve it, we think that it is a perfectly good tool and it supports IR35 compliance …

**Chair**… One of the things that people have been saying to us is that there is real worry that they will have gone through the CEST process and calculated the tax that they owe, but you could then go back and investigate and say that CEST did not apply to them. Are you saying that that is not the case for people—well, for the

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335 op.cit. p14 (fn17)  
336 “Hot topic”, *Taxation*, 10 May 2018. The ICAEW has also raised concerns about CEST (*Modern working practices and off payroll working: Representation 40/18*, 5 April 2018). See also, “Fixes required”, *Taxation*, 29 November 2018.  
337 Public Accounts Committee, *HMRC’s performance: progress review - oral evidence*, HC 972, 30 April 2018
85% who get that first resolution—who have gone through your calculator? Are you saying that that is accurate, to a degree?

Jim Harra: What we have said to people is that if they use our tool correctly and put the correct data into it, we will abide by the result that the tool gives.

Chair: How do you assess whether they have put the correct data in? That is an important caveat. How do you make sure? They could make a genuine mistake.

Jim Harra: That is something we would do through our employer compliance checks. For example, last year, public sector engagers were required to make their own determinations of whether the companies they were contracting with were caught by IR35. They use the CEST tool to do that. We can come along later and audit their compliance with their employer obligations, including the obligation to administer IR35 and deduct tax, and we will check whether they have used the tool correctly and made the correct assessments.

For example, in some organisations, the contract says certain things but in practice other things happen and the contract does not reflect the real nature of the relationship between the engager and the worker. In those circumstances, we expect them to use the reality. That is the kind of thing that we would check.

Further to this, in September 2018, in response to an FOI request, HMRC published details of its work in testing CEST against actual cases where someone’s employment status was determined.

Up to April 2018, HMRC tested CEST against 24 cases. In two of these CEST returned a different decision to the First-tier Tribunal, which HMRC had not appealed: namely, Novasoft Limited [2010] UKFTT 150 (TC), 6 April 2010; and, Castle Construction (Chesterfield) Ltd Spc00723, 3 December 2008. Commenting on these cases, HMRC noted, “In these specific cases, the judgment in Castle Construction (Chesterfield) Ltd acknowledged that the case was finely balanced. In the case of Novasoft Ltd commentators expressed surprise at the results. HMRC would expect to contest similar cases in future, and the CEST results reflect that position.”

Another criticism that has been made of CEST is that it does not take ‘mutuality of obligation’ into account in its determination. This is discussed in the text box over the next three pages.
HMRC's CEST tool and mutuality of obligation

One of the tests that has been applied in determining employment status is ‘mutuality of obligation’ – often termed ‘MOO’. In their report on employment status published in 2015, the Office for Tax Simplification discuss what it is, and how it has been used.

Mutuality of obligation

Mutuality of obligation or the “irreducible minimum of obligation” are concepts that have evolved from a statement made in a case1 in 1941. The test was then expanded in Ready Mixed Concrete.2 The irreducible minimum of obligation was further expanded in Nethermere3 in 1984 where Stephenson LJ stated that: "There must … be an irreducible minimum of obligation on each side to create a contract of service…” That statement in itself, however, then spawned more case law on whether the absence of mutuality of obligation was fatal to the existence of a contract of employment or merely just a powerful pointer.

The problem with mutuality of obligation is that it may give a different result depending on whether it is used for tax or employment rights purposes. Mutuality of obligation is predominantly used in employment rights cases because the individual is seeking to establish that they can create a global contract from a series of short assignments in order to obtain the continuous services necessary to gain full employment rights, currently 24 months.

For employment rights purposes, the court will look at the time when the individual wasn’t working between contracts and if there is no mutuality of obligation in this period the case will “…founder on the rock of absence of mutuality…”4 It was stated in that case, however, that “…no issues arise as to their status when actually working [as guides].” Indeed, in its Employment Status Manual HMRC states that “The case is not justification for claiming that people working on a “casual as required” basis cannot be employees.”5

There is much argument as to what mutuality of obligation actually means. In its simplest form “…in consideration for a wage… he will provide his own work in the performance of some service…” could apply equally to a contract of employment or a contract for services. For there to be a binding contract of any kind, there must be “valuable consideration” given by both parties. It followed in Nethermere, that: “…there must… be an irreducible minimum of obligation on each side to create a contract of service. I doubt if it can be reduced any lower than in the sentences I have just quoted…”.

It may be that mutuality of obligation means you have to provide your own work and skill for a wage, bringing in ‘personal service’, or that there has to be a continuing obligation outside of the contract as argued in Prater6, or that ‘pay’ is the key criterion, i.e. that the perceived employer has to pay regardless of whether there is any work. What is certain is that there is no consistent opinion.

Notes:

1 Stable J in Chadwick v Pioneer Private Telephone Co. Ltd. [1941] All E.R. 522, 523D: “A contract of service implies an obligation to serve, and it comprises some degree of control”
2 By MacKenna J in Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance [1968] 2 QB 497
3 By Stephenson LJ in Nethermere (St Neots) Ltd v Gardiner [1984] ICR 612
5 ESM 7200 - Case law: Carmichael v National Power plc
6 Cornwall County Council v Prater [2006] EWCA Civ 102

Office for Tax Simplification, Employment status report, March 2015 para 2.33-36
HMRC’s CEST tool and mutuality of obligation contd.

HMRC’s CEST tool does not look explicitly at whether there is mutuality of obligation in a specific case. HMRC’s view has been that anyone using CEST would have already established MOO, which is necessary for a contract to exist, otherwise there would be no need to be using CEST to determine the status of the existing or hypothetical contract. At a meeting of the ‘IR35 Forum’ in December 2017 HMRC officials acknowledged that “this view has been challenged in the press and by some members of the forum”, and stated it would provide “a considered response, suitable for publication” in the new year (IR35 Forum Minutes, 11 December 2017).

Following responses from Forum members to its first draft, HMRC’s published this in summer 2018 (IR35 Forum Minutes, 30 August 2018; PQ168138, 7 September 2018). This is reproduced below:

A basic requirement of any contract is consideration – the parties must be obliged to exchange something of value. In an employment contract, the main consideration will be work in exchange for pay. Mutuality of obligation will also exist in contracts for goods or services.

Where contractual obligations are conditional upon an event mutuality of obligation will exist, even though the event may not take place. The parties are nonetheless obliged to fulfil their obligations if the event occurs.

Where an arrangement doesn’t oblige the parties to do anything, it isn’t a contract, even if it’s called an ‘agreement’ or labelled a ‘contract’. It may be a head of agreement or offer setting out the terms on which a contract may take place. A head of agreement will become a contract, subject to any variations or implied terms, when the offer is accepted. The acceptance of an offer may be established by the conduct of the parties, such as providing labour.

The fact that a contract may be terminated does not affect mutuality of obligation during the contract, even if it may be terminated without notice. The fact that the duration of such a contract is uncertain is irrelevant to mutuality of obligation, whilst the contract continues. Where a person is engaged in a series of contracts and there is no mutuality of obligation between each engagement this is irrelevant to mutuality of obligation during each engagement.

Where work is provided and remuneration is paid we will assume that there is mutuality of obligation and that a contract exists. We will consider whether this is an employment contract or a contract for services. We will be sceptical of an assertion that no mutuality of obligation - and logically no contract – exists in these circumstances.

We will consider a range of factors to establish whether a contract is an employment contract or a contract for services. This is distinct from consideration of mutuality of obligation, which will already have been established. For the avoidance of doubt the CEST online tool assumes that a contract exists or is being considered. We do not anticipate the tool being used outside of these circumstances.

Issues such as substitution and delegation should be taken into account when considering if a contract is consistent with an employment contract. This approach was established in Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance (1968) in which McKenna J observed that a limited or occasional power of delegation may be consistent with an employment contract. A useful precis of case law relating to personal service is contained in the recent Court of Appeal judgement in Pimlico Plumbers & Another v Smith (2017).

Where a worker is engaged on an assignment by assignment basis this may be a relevant factor, but will not be determinative.
Turning back to the Government’s consultation, both the Chartered Institute of Taxation, and the Low Incomes Tax Reform Group published their responses.

In the first case the CIOT suggested the Government should explore an alternative approach, “whereby businesses e-file a report of payments made to PSCs, and their view of whether the PSC should be applying IR35, to HMRC on a regular basis. By also expanding existing questions on PSCs on workers’ tax returns this would enable HMRC to follow-up...
directly with the PSC to check up on whether the PSC has applied IR35 to an engagement.”

A longer extract from the CIOT’s response is copied below:

We think that an approach that (i) builds on existing record-keeping requirements and a requirement to secure supply chains but (ii) which also requires the business to e-file a report of payments made to PSCs to HMRC on a regular basis (and perhaps also to provide a CEST report to evidence whether or not the business considered that the PSC should be applying IR35), is worth seriously considering. It could prove a much less administratively burdensome and more cost-effective alternative to tackling compliance with IR35.

The information from the business would allow HMRC to focus its efforts and follow-up directly with the PSC immediately after the end of the tax year to check up on the position. And by expanding the existing SA tax return question on PSCs to include a much greater information requirement where the worker is employed by a PSC but not operating IR35 and a significantly increased penalty for non-compliance, this would signal HMRC’s resolve in enforcing IR35.

Furthermore, if the worker is made jointly liable for PSC debts of PAYE/NIC that would also concentrate the individual’s mind much more on ensuring that due attention is paid to IR35. As opposed to tying up HMRC and FTT time and resources as a result of an appreciable number of PSCs electing to challenge engager decisions to deduct at source with the argument that such decisions were based on an abundance of caution.

In their case, the LITRG argued that the Government should “defer making a decision for a year or two” and in the meantime “HMRC should refocus on ordinary IR35 investigative work”:

In the event that off-payroll working for the private sector is rolled out in due course, we strongly recommend that an exemption is applied to small businesses. We have significant concerns about the impact that the roll out of the public sector rules would have on this constituency …

Small businesses are less likely to have the technical expertise or capacity to understand and apply the new rules than public sector bodies. If they are not exempt, many would be forced to pay for professional advice or assistance if they were to engage a worker via a PSC, which they may not be able to afford. Alternatively, they would have to dedicate time and resources to getting to grips with the new rules themselves, which would be disruptive, stressful and potentially affect productivity …

We also have severe reservations about how useful HMRC’s online Check Employment Status for Tax (CEST) tool would be in the context of small businesses with non-specialist staff. The tool will need to be redesigned and this is just one of the reasons that any changes to the private sector will need a significant lead-in time.

We are also concerned about the impact of any changes on low-income workers in PSCs – something not really addressed in the

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340 CIOT press notice, Better data sharing with HMRC can offset need for extension of 'off-payroll' working rules, 10 August 2018
341 CIOT, Off-Payroll working in the private sector: CIOT Comments, 7 August 2018 para 2.13
consultation document. Such workers are probably not in a PSC out of choice, but at the behest of an agency or other intermediary, such as an umbrella company, who can then save on employer National Insurance contributions (NIC) and can also charge an ongoing fee for ‘accountancy’ services to help the worker run the PSC. 342

There was relatively little debate on this issue in the House, though the impact of public sector reform, and the potential impact of private sector reform, was raised in a number of PQs, for example:

**Asked by Julian Sturdy:** To ask Mr Chancellor of the Exchequer, what representations his Department has received from people and organisations affected by off-payroll working rules and changes to IR35 regulations on those rules and changes; and what proportion of those representations have been critical of the IR35 changes.

**Answered by: Mel Stride:** The government has consulted widely on off-payroll working rules (known as IR35), since the Summer Budget 2015. In July 2015, the government published the ‘Intermediaries Legislation (IR35): discussion document’, which sought views on the existing rules and options for change.

After Budget 2016, the government published the consultation document, ‘Off-payroll working in the public sector: reform of the intermediaries legislation’. HMRC met with over 500 people from a wide range of organisations to discuss the proposed changes, and received over 200 written responses to the consultation.

Following the introduction of the new rules in April 2017, the government commissioned independent research into the impact of the changes. This was published on 18 May 2018 and is available to view online. The government’s assessment is that the reform has been successful in increasing tax compliance for off-payroll workers in the public sector. The government is now consulting on possible reform to the off-payroll working rules in the private sector. As part of that consultation, HMRC is planning to meet over 200 people, including representatives of a wide range of affected stakeholders. 343

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**Asked by Grant Shapps:** To ask Mr Chancellor of the Exchequer, what estimate his Department has made of the number of people who will be directly affected by changes to IR35.

**Answered by: Mel Stride:** In 2016, when the Government consulted on possible reform of the off-payroll working rules (known as IR35) in the public sector, it estimated that around 26,000 people working through personal service companies would be affected by the changes. Reform to the rules in the public sector were introduced in April 2017. The Government is currently consulting on how to tackle non-compliance with the current rules in the private sector. No decisions have been made on any changes to those rules. 344

342 LITRG, *Consultation on off-payroll working in the private sector*, 9 August 2018 paras 1.2, 1.4, 1.6–9

343 PQ150081, 13 June 2018

344 PQ153789, 19 June 2018. See also, PQs162078 & 162709, 17 July 2018
8.3 Budget 2018

The then Chancellor Philip Hammond presented the Government’s Budget on 29 October. In his Budget speech Mr Hammond confirmed that the Government would proceed with extending the public sector reforms to the private sector, but the new rules would only apply from April 2020:

The off-payroll working rules, known as IR35, are designed to ensure fairness so that individuals working side by side in a similar role for the same employer pay the same employment taxes. Last year, we changed the way these rules are enforced in the public sector, but widespread non-compliance also exists in the private sector, so following our consultation, we will now apply the same changes to private sector organisations as well.

But after listening carefully to representations made—including many from right hon. and hon. Friends—during the consultation, we will delay these changes until April 2020, and we will only apply them to large and medium-sized businesses.345

It was estimated that the reform will raise around £2.97 billion over the six years to 2023/24.346 It is worth noting that in assessing the level of uncertainty to the costings of all of the Budget measures, the Office for Budget Responsibility considered this estimate ‘very highly’ uncertain:

‘Off-payroll working: extend reforms to private sector in 2020-21, excluding small businesses’:

This measure relates to the taxation of off-payroll workers who work for a private sector client through their own intermediary, such as a personal service company. This allows them to pay less tax and NICs than employees. Rules are already in place to ensure that when a worker can be shown to work in effect as an employee, then the tax and NICs due would be broadly the same as an employee. This measure moves the burden of responsibility for determining whether existing rules apply to the engager (i.e. the private sector business) rather than the intermediary. HMRC expects this to increase compliance and revenue.

There are multiple sources of uncertainty with the costing.

No information is directly held on the tax base, which has had to be estimated using a series of very uncertain judgements. The costing assumes a high level of attrition as it is deemed very likely that individuals will continue to seek ways of minimising the tax they pay. A previous measure that targeted similar workers in the public sector has so far raised more than originally expected, but non-compliance is assumed to be greater in the private sector.

Overall, we give this a ‘very high’ uncertainty rating, with data, behaviour and modelling all deemed to be sources of ‘high’ or ‘very high’ uncertainty.347

HMRC’s estimate of the scale of non-compliance with IR35 is that, unchecked, it would cost the Exchequer £1.3 billion by 2023/24.348 At a

345  HC Deb 29 October 2018 c661
346  specifically, -£5m in 2018/19; -£150m in 2019/20; £1,165m in 2020/21; £595m in 2021/22; £635m in 2022/23; and £725m in 2023/24 (Budget 2018, HC 1629, October 2018, Table 2.1 – item 54).
347  OBR, Economic and Fiscal Outlook, Cm 9713, October 2018 para A15
348  HMT, Off-payroll working rules from April 2020: Factsheet, July 2019 para 1
meeting of the IR35 Forum in February 2019, members asked whether this estimate was not at odds with the estimate the Government has made of the revenue impact of this reform:

Members raised a question about the perceived discrepancy between the estimated impact of non-compliance (£1.3 billion in 2023-34), and the estimated amounts of additional revenue in the same year (£725 million in 2023-24). There is no discrepancy. There is normally a difference between the estimate of Exchequer cost of non-compliance and the estimated yield from measures to address it because of a range of factors including behavioural impacts and the design and scope of a measure.349

The Government published a summary of the responses to the consultation, with its conclusions, alongside the Budget. 275 responses were received “from a range of stakeholders including individuals working through PSCs, businesses, representative bodies, tax professional bodies, law firms and charities.”350 Many respondents agreed that non-compliance with IR35 should be tackled, though the “the vast majority … were concerned about the increased burden that the changes would impose on businesses”, with several calling for “small and micro businesses to be exempted from any changes.”351

There were specific concerns about the impact of the public sector reforms, the operation of CEST, and “the compatibility of CEST determinations with recent tribunal decisions”, while “a large number of respondents suggested the introduction of a dispute resolution process and an appeals mechanism to allow workers to challenge incorrect determinations.”352

During the consultation the Government approached public sector organisations on the impact of the 2017 reforms:

Public bodies reported experiencing challenges in implementation, due to the short time available for familiarisation, setting up appropriate systems and reviewing existing contracts. Some suggested that lack of awareness among some contractors of the rules or the reform exacerbated disputes about determinations. In terms of the impact on the use of flexible labour, some public bodies suggested that recruitment was more challenging where contractors provided specialist skills and had the option to move to private sector contracts.353

Nonetheless, “tax receipts and independent research suggest that the reform has increased compliance and has not had a widespread impact on public bodies engaging flexible workers where it is in the best interest of both parties to work in this way.”354

In taking the decision to extent this reform to the private sector, the Government stated that it would defer implementation until April 2020, and would exempt small businesses from the general requirement for

349  IR35 Forum Minutes, 28 February 2019 para 33
350  HMT/HMRC, Off-payroll working in the private sector: summary of responses, October 2018 para 1.6
351  op.cit. para 2.5, para 2.8-9
352  op.cit. para 2.5, para 2.8-9
353  op.cit. para 2.16
354  op.cit. p10
private sector client businesses to determine if IR35 should apply to PSCs supplying them with services:

The government agrees that it is important to consider the administrative burden on businesses and their capacity to implement change. This is why, having listened to feedback, the government has decided that for services provided to small businesses, the responsibility for determining employment status and paying the appropriate tax and NICs will remain with PSCs. Small businesses will not need to consider the employment status or deduct employment taxes from the fees of people they engage in this way. This will address concerns about small businesses’ capacity to implement the proposed reform, while ensuring that businesses which are best placed to determine whether the rules apply take responsibility for doing so. The government intends to use similar criteria to define small businesses as is found in the Companies Act 2006.

However, it remains the case that individuals working for small businesses should pay the tax appropriate to the way they work. Therefore, the responsibility of determining employment status and paying the appropriate tax and national insurance contributions will remain with personal service companies, for the services they provide to small businesses. As a result, over 95% of businesses will not need to apply the reform.

On the question of misclassification, and the right of workers to challenge a determination, the Government stated that, “HMRC will publish detailed guidance and provide support and education to help customers understand and implement the changes … HMRC will also set out what people should do when they do not agree with the business’ decision on their employment status.” On the operation of CEST, the paper confirmed that HMRC would introduce enhancements “in advance of the new rules coming into force”:

HMRC is looking at where the CEST tool, along with wider guidance, might be improved, both as part of normal good practice and to ensure it reflects the needs of the larger and more diverse private sector. HMRC will work in collaboration with stakeholders to better understand the concerns about CEST raised in response to this consultation; these included saying more about mutuality of obligation, how to treat multiple contracts and clarifying the language used in places.

It went on to underline that “a further consultation on the detailed operation of the new rules will be published in the coming months. This consultation will inform the draft Finance Bill legislation, which is expected to be published in Summer 2019.”

In their coverage of the Budget, the Financial Times quoted, IPSE, a group representing freelancers, as saying:

“It is a short-term tax grab that will do lasting damage to the economy by taxing out of existence the smallest and most agile businesses. The off-payroll rules are so complex and crude that genuinely self-employed people will be swept up by the..."
government’s smash-and-grab mentality and in many cases taxed out of operation.”

It also quoted Julian Sansum, employment tax partner at PwC, the professional services firm, as saying:

“Having a single set of rules for taxing contractors in both the public and private sectors is a sensible step. But the impact of these reforms should not be underestimated and arguably represent the most significant changes to the operation of employment taxes for many years.”

The ContractorUK site provided an update for views from campaigners, which underlined that many stakeholders were waiting on the second consultation next year before taking any definitive view as to the impact of this reform. Writing in Taxation, Alastair Kendrick concluded, “I suspect that these proposals will activate considerable comment on social media and extensive lobbying, but it appears the government is determined to stand firm and introduce these extra controls to ensure those who work though a personal service company pay the correct amount of tax. Ultimately, we await the consultation document for more details on how the scheme will operate in practice.”

In their response to the Budget the Chartered Institute of Taxation (CIOT) welcomed the delay but argued that there would continue to be serious problems in determining when the rules applied in individual cases. Victoria Todd at the Low Incomes Tax Reform Group (LITRG) raised concerns about the potential impact:

“We appreciate the Government have concerns around IR35 compliance, which we share; and we welcome HMRC’s commitment that they will not use these changes as an opportunity to look into historic compliance issues … an exemption for small businesses is welcome, particularly as HMRC’s Check Employment Status for Tax tool is not the Holy Grail that they think it is …

“But there is another dimension to this story – the impact on the workers who are working through a limited company for medium and large business in the private sector. It is well known that many low-paid workers, such as temporary workers who find work through agencies and other intermediaries, are only in limited companies in the first place at the behest of the intermediaries that engage them, as this saves those businesses employers’ NIC and often provides them with an additional revenue stream through providing the worker with ‘accountancy services‘.

“If the intermediary concludes that the new rules effectively neutralise the tax advantages of these arrangements, it is likely that workers will be pulled out of limited companies. If what we saw after the public sector changes is anything to go by, they

359 “Freelancers face higher tax in Treasury crack down”, Financial Times, 29 October 2018
360 “Devil in the off-payroll rules’ detail awaits contractors in 2019”, ContractorUK, 30 October 2018
361 “Public rules for the private sector”, Taxation, 14 November 2018
362 CIOT press notice, Delay in introducing changes to the off-payroll worker rules in the private sector welcome but real challenges remain, 29 October 2018
could then find themselves encouraged into other dubious arrangements that help engagers protect their profitability.

“In addition, HMRC must be aware that the abandonment of limited companies could create some very messy compliance issues – made worse by the fact that often the workers involved have little understanding of how such vehicles operate …

“If businesses do respond by forcing the abandonment of limited companies, it could happen on a large scale with many workers affected. The Government will need to be prepared and will need to consider their response very carefully.”

As part of the Treasury Committee’s inquiry on the 2018 Budget, the Committee invited written evidence from the four main accountancy organisations on the tax measures in the Budget, and each mentioned the Government’s decision regarding the off-payroll worker rules.

The Tax Faculty of the Institute of Chartered Accountants (ICAEW) argued that the decision was “not unexpected”, and welcomed the one-year delay to implementation, but listed “some immediate additional problems with making the change in the private sector”:

- Educating the contracting workforce will be more challenging in the private sector since the population will be much larger and more difficult to reach.
- It will not always be obvious to the worker whether they are working for a small or larger business and it will be unclear where responsibility lies.

The ICAEW went on to note, “Matthew Taylor’s report in 2017 highlighted the problems caused by having two different sets of rules for determining status in tax and employment law, along with the problems caused for employment law of having three status’, employed, worker and self-employed. We still need a national debate about this rather than more tinkering with the tax system.”

In their evidence the CIOT welcomed the delayed implementation date, and the small business exemption, but raised concerns as to the practical difficulties for both HMRC and individuals:

3.2 It was perhaps inevitable that the off-payroll rules would be extended to the private sector, given the inequity and loss to the Exchequer in the growth of off-payroll arrangements. It is welcome that implementation will not take place until April 2020, to allow businesses time to prepare for the changes and for HMRC to work with stakeholders to improve operation of the existing public sector rules. We also welcome the fact that the rules will only apply to large and medium-sized engagers, as they can be complex and administratively burdensome to apply.

3.3 The dividing line between employment and self-employment can be unclear. Extending the rules to the private sector places greater onus on HMRC to help both the engagers and those who are engaged identify where that dividing line sits, and provide guidance on the implications for both parties. It would have been preferable if the Chancellor had initiated public consultation on

363 LITRG press notice, IR35 small business exemption welcome but what about the workers?, 29 October 2018
364 Treasury Committee, 2018 Budget: Written Evidence (ICAEW), 5 November 2018 pp10-11
clarifying this dividing line, as its uncertainty is both a problem for those who try to comply and a temptation to the unscrupulous.

3.4 There will also be complexities for individuals who cease operating through a company or are ‘encouraged’ into a different arrangement by their engager. HMRC, and other parts of government, will need to be aware of these potential issues and provide support to help those individuals get their taxes right.365

The Association of Certified Chartered Accountants (ACCA) argued that despite the one-year delay “the fundamental design flaws remain. And that, “there are concerns that the case has not yet been made for retaining the existing changes in the Public Sector”:

HMRC maintain that the public sector rollout is working. However, this is not consistent with the overwhelming majority of commentary from other stakeholders in the economy. Trade bodies have reported concerns, and it has been widely reported that several public sector projects have been halted or significantly delayed after large numbers of contractors declined to engage on the new terms. HMRC state that they have not seen evidence of such disruption ...

Many contractors feel it is grossly unfair to subject them to full employment taxes while denying employment rights. On the flip side of this, engaging “disguised employees” through intermediaries could offer unscrupulous employers a long term benefit, with wider compliance costs reduced. These problems would sit alongside wider changes to work patterns which have raised other concerns about the long term sustainability of the existing tax framework. It is a major source of disappointment that the government is pushing ahead with expensive, disruptive and possibly superfluous tax reforms with the underlying problems still to be addressed.366

The Association of Tax Technicians (ATT) also raised doubts as to whether the public sector reforms were, in fact, working as well as had been claimed:

A one-year delay aside, there remains an absence of robust, independent evidence to evaluate the effectiveness of off-payroll working in the public sector. However, there is a plethora of anecdotal evidence from a wide range of sources that suggests it is not operating effectively. It should therefore not be extended to the private sector until there is robust, independent evidence of its effectiveness.367

The Committee also held some evidence sessions, and at one of these, the then Chair of the Committee, Nicky Morgan, asked Rain Newton-Smith, the CBI’s Chief Economist, for her view of the impact of this announcement:

Q175 Chair: Just one final question on IR35. It might be best directed at Ms Newton-Smith. What impact do you think the changes will have on the labour market? Do you think private sector businesses will change employment practices? Is there a problem from the CBI’s perspective, and do you think that private

365 2018 Budget: Written Evidence (CIOT), 5 November 2018 para 3.2-4
366 2018 Budget: Written Evidence (ACCA), 13 November 2018 p3
367 2018 Budget: Written Evidence (ATT), 13 November 2018 para 3.39
sector businesses will change their practices as a result of the changes the Chancellor has proposed?

**Rain Newton-Smith:** Everyone recognises that the system needs reform. In terms of what was announced at Budget, it was welcome that small businesses were exempt because of some of the challenges around the administrative burden. Obviously that is proportionately higher if you are a smaller business. What’s most important is that it will be implemented from 2020. As with any change in legislation or regulation, giving businesses time to prepare is really important, particularly where in some cases it requires investment in IT systems or having someone within an HR department who can do the determination for individuals, whether they are employees or self-employed, because essentially it shifts the burden on to companies.

One of the challenges is that, as much as HMRC may find it difficult to decide whether someone is self-employed or a contractor, it is hard for companies as well. Again, having that time is important, and it does involve cost. We have seen that the set-up costs involved can run up to £7,500 in some cases, and for some businesses the overall cost of compliance can run into hundreds of thousands of pounds. Businesses recognise that this change is coming and that it was something that needed to be implemented.

Another point I would make is that we really need to learn the lessons from how it has been applied in the public sector, because there have been challenges in implementation. We really want to learn the lessons from that. We want to look at the evidence and then apply the lessons learnt to how it is applied in the private sector.

We know there are some challenges with the online tool for determining whether people are employed or self-employed. More fundamentally and stepping back from the issue, you would ultimately—in some senses this is looking at the tax treatment—probably want to do it in a more holistic way and have a better alignment between the taxation of employment and self-employment and also the rights associated with it. One of the challenges with this is that you are addressing one element of the tax determination without also addressing the rights that are accorded to employees and the self-employed at the same time.368

Later the same month the Committee took evidence from HMRC’s then Permanent and Second Permanent Secretaries, Jon Thompson & Jim Harra. Most of the session focused on Brexit, although Colin Clark asked about IR35 and, specifically, how contractors would be able to appeal against an assessment by their engager …

**Q249 Colin Clark:** … The Budget announced there is going to be an expansion of the IR35 measures from the public sector to the private sector … being slightly cynical, is the Government outsourcing the responsibility for making sure that contractors who are not complying with IR35 rules pay the right tax?

**Jon Thompson:** At the minute these arrangements are all entirely between two private sector entities. I think the Government have been relatively transparent about what they are doing here, changing who is deciding from the supplier—let’s use that

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368 Budget 2018: Oral Evidence, HC 1606, 1 November 2018 Q175
word—to the engager. Where those are currently two private sector entities then it is shifting to the employer, yes.

**Q250 Colin Clark:** That comes back to the point I was making earlier about employers taking responsibility.

**Jon Thompson:** Yes. To be completely transparent with you as tax administrators, the more intermediation there is in a market the higher the standards of tax administration.

**Q251 Colin Clark:** … How will the legislation give contractors a clear route of appeal if they disagree with a decision about their employment status? … The point is that given concerns that businesses engaging contractors will err on the side of caution and treat contractors within IR35 rules when they should not be. How could that arise?

**Jim Harra:** The way it will work—and the way it currently works in the public sector—is that the private sector engager will have to make a decision about whether the nature of the relationship is an employment one, in which case they will operate pay-as-you-earn, or self-employment, in which case they will pay gross and they will leave it to the contractor or the personal service company to pay their tax.

Anyone who feels that the wrong decision has been taken and that they are being taxed under the wrong route—they are not in employment but are in self-employment—obviously has the ability through self-assessment and corporation tax self-assessment to challenge that and to seek for it to be changed. Our aim is obviously that most of these decisions are straightforward. We want to see the very high level of non-compliance that we have experienced with the old IR35 rules transformed into a very high level of compliance. We believe a lot of the decisions that are currently being taken are the wrong ones and we will see more correct decisions in future.

… and the wider question of the differences in the tax treatment of employment and self-employment:

**Q253 Colin Clark:** … Is not the whole problem because the self-employed and employees are all taxed differently when, to all intents and purposes, they are all doing the same job?

**Jim Harra:** First of all obviously the IR35 rules do not apply to people who are genuinely self-employed. They apply to people the nature of whose relationship is one of employment. You are right that the tax system contains lower tax for self-employed people compared to employed people.

**Colin Clark:** That is the comparison, is that fair?

**Jim Harra:** Lower tax again for corporates compared with self-employed and employees. That clearly creates incentives for people to try to shift themselves into one of those lower tax groups, which is what we see. You can understand policy reasons for why you might have those differences but there is no doubt they then create incentives for behaviours that we have to shore up with things like the IR35 rules … which are designed to prevent that from happening.369

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Over 2018 the Treasury Sub-Committee conducted an inquiry on the conduct of tax enquiries, and in December took evidence from Ray McCann (CIOT President) and Tony Lennon (from the BECTU sector of Prospect) at which IR35 was discussed. On this occasion Mr Lennon gave some insight into the practical implications of the public sector reforms for those working in the film, tv and entertainment sectors:

I have to say that the level of compliance seemed to be fairly good. In other words, public sector engagers, partly because they have big HR departments, legal advice and stuff like that, were generally playing by the rules and not putting people in a position where, if they billed through a limited company, they were running the IR35 tax risk.

What we have seen happen inadvertently is this. A number of people who we believe are genuinely operating businesses in their own right—there is no deemed employment payment arising—and should be treated as self-employed, working through a personal service company, have been put on to PAYE. It’s not a massive number, but a few have …

From our point of view, there are two crucial flaws [to CEST]. The first is that when it tests on provision of personal services it does not give enough weight to your right to send a substitute on a qualified basis; it is looking for an absolute right to send a substitute. The other flaw in that online checker is that it does not test at all for whether you have multiple engagers. Working for lots of different people of course is one of many indicators of potentially self-employed status …

Typical engagements in our sector are actually quite short … There is a test case in this area—Hall v. Lorimer. Mr Lorimer was a member of our union, and I think he was able to demonstrate that he had had over 100 engagers in the course of a year. I would say that predominantly, our self-employed members, who are working mostly as sole traders, some of them through personal service companies, have a multitude of different engagers over the course of a given year.

In turn Mr McCann echoed Mr Lennon’s concerns about the application of the CEST tool to those with multiple clients:

I agree with the point Tony made about multiple clients … if, as in the Hall v. Lorimer situation, you have 100 clients in a year, it is almost certain that any judge would find that you were self-employed … However, of late, HMRC have been suggesting to me that each individual contract has to be tested separately. I think that is going too far. With the IR35-type scenario, at the extremes you see cases that seem obviously open to challenge by HMRC, but you see other cases where it is difficult to understand why HMRC are challenging them at all, because there do appear to be multiple clients. But there are undoubtedly a number—I cannot give you even a percentage—where it is single user, effectively. That, essentially, is the classic model that IR35 was introduced to try to combat.

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370 [Hall v Lorimer[1994] 66TC349. This is discussed in HMRC’s Employment Income Manual— see para 7160, and has been cited in past IR35 tribunal cases: see, MDCM Ltd v HMRC, [2018] UKFTT, 12 April 2018 para 42].

371 Treasury Sub-Committee, Oral evidence: The conduct of tax enquiries and resolution of tax disputes, HC 733, 10 December 2018 Q113, Q115

372 op.cit. Q116
8.4 Recent IR35 tribunal cases (Spring 2019)

In February 2018 there was widespread press coverage of the case of Christa Ackroyd, past presenter of the BBC Look North programme. Ms Ackroyd had provided her services through a PSC, and the tribunal upheld an assessment by HMRC that the PSC should have applied IR35 over the period of time she was engaged by the BBC.

As discussed in section 7 of this paper, the case coincided with concerns about the impact of the public sector reforms, and that in the past the BBC had actively encouraged presenters to work through PSCs without concerns for their compliance with IR35.373

At the time there were reports that HMRC were pursuing a number of similar cases, and in early 2019 there were two First-tier Tribunal (FTT) decisions: the first involving Lorraine Kelly, involving her work presenting on ITV;374 the second involving Kay Adams who had been engaged by the BBC but who had also worked for ITV and Sky News.375 In both cases the FTT ruled in favour of the presenter’s PSC which had not applied IR35 – for a four year period when Ms Kelly presented two shows on ITV, and for a two year period when Ms Adams presented a programme on BBC Radio Scotland.

In the first case, the judge noted that the appellant’s case “relied, in the main, on the absence of control as a significant indicator pointing away from a contract of services”:

In this case Ms Kelly was engaged for her specific skill. We accepted the evidence of Ms Walton and Professor Shalit [a tv producer and the head of a talent agency who both worked with Ms Kelly] that in relation to [the two shows she presented on ITV] … it was Ms Kelly’s “brand” that was specifically engaged … it was clear from the evidence that Ms Kelly had minimal or no supervision. We accepted Ms Kelly’s evidence that she decided on the running order of the programme, the items to feature and the angle to take in interviews. In looking at the overall picture we were wholly satisfied from the evidence that contrary to being part of a jigsaw, Ms Kelly was the jigsaw.376

The tribunal also considered the nature of Ms Kelly’s work, as HMRC had contested the tax-deductibility of the fees she paid her agent. Entertainers are entitled to offset, in part, agent fees against their employment income,377 and HMRC had argued that Ms Kelly could not be considered to be a theatrical artist because her work was essentially that of a newsreader. The tribunal disagreed:

We did not accept that Ms Kelly simply appeared as herself; we were satisfied that Ms Kelly presents a persona of herself; she presents herself as a brand, and that is the brand ITV sought when engaging her. All parts of the show are a performance, the act being to perform the role of a friendly, chatty and fun

373 Christa Ackroyd Media Ltd v HMRC [2018] UKFTT 69. See, “HMRC wins tax case against BBC presenter”, Guardian, 15 February 2018
personality. Quite simply put, the programmes are entertaining, Ms Kelly is entertaining and the “DNA” referred to is the personality, performance, the “Lorraine Kelly” brand that is brought to the programmes. We should make clear we do not doubt that Ms Kelly is an entertaining lady, but the point is that for the time Ms Kelly is contracted to perform live on air she is public “Lorraine Kelly”; she may not like the guest she interviews, she may not like the food she eats, she may not like the film she viewed but that is where the performance lies, as no doubt with other entertainers such as Ant and Dec or Richard and Judy. For that reason, we have no hesitation in concluding that Ms Kelly is a “theatrical artist” and the legislation is satisfied such as to make the expenses deductible.\textsuperscript{378}

In the \textit{Tax Journal}, David Whiscombe (BKL Tax) reviewed the outcome of the cases of Ms Ackroyd and Ms Kelly, arguing that the degree of control the BBC had over Ms Ackroyd’s engagement was a crucial factor, but the difference was surprisingly slight:

Without meaning any disrespect to the taxpayers, counsel or the tribunal itself, it’s tempting to see Ms Kelly was luckier. Either case could, perhaps, have gone either way and might have done so on a different day. Such a lottery is no way to run a tax system.\textsuperscript{379}

Heather Self (Blick Rothenberg) made a similar point in a second piece:

While every case turns on its own facts, the nuances in these two cases are subtle indeed. (It is understood that the \textit{Christa Ackroyd} case is being appealed to the Upper Tribunal.) … The current situation leads to risks, for both contractors and (increasingly) those who engage them, which are hard to manage. Continuing to try to apply poorly-defined rules to an ever-larger populations is surely not a good way to run a tax system.\textsuperscript{380}

Subsequently Mr Whiscombe reviewed the case at more length in \textit{Taxation}, concluding that, “a niggling doubt remains about whether [the two cases] … were really quite different enough to warrant these contrasting conclusions”:

Ms Kelly is a star entertainer performing on national TV; Ms Ackroyd a lower-profile regional news journalist. Did that make any difference? Should it? Would the results have been different if Ms Ackroyd had come over a little more favourably as a witness; or if she had been able to count on the support of the engager as Ms Kelly did? Ms Kelly will be delighted (and, we suspect, not a little relieved) with her result; Ms Ackroyd may be pondering what might have been.\textsuperscript{381}

In their report on the case the \textit{Financial Times} quoted Joe Tully (Brookson Legal): “the question of control is key to determining if a person is employed or self-employed and clearly HMRC has struggled with interpreting this.” Mr Tully went on to note the proposed reform to the application of IR35 in the private sector meant that businesses would have to apply rules that were “clearly complex and difficult to interpret … This further underlines the need for businesses to take

\textsuperscript{378} Albatel Ltd v HMRC [2019] UKFTT 195 para 193. See also, “Lorraine Kelly is a theatrical artist, tax tribunal judge rules”, \textit{Guardian}, 20 March 2019

\textsuperscript{379} “Spot the difference: Ackroyd and Kelly”, \textit{Tax Journal}, 29 March 2019

\textsuperscript{380} “Self’s assessment: employed or self-employed?”, \textit{Tax Journal}, 5 April 2019

\textsuperscript{381} “Jigsaw puzzle blues”, \textit{Taxation}, 18 April 2019
action now to prepare for the challenge these changes will present. “382

In the Tax Journal, Dawn Register & Rob Woodward (BDO) also raised concerns about the impact for private sector organisations having to monitor compliance with IR35:

There are repeated calls, including from the industry bodies and the ICAEW, to delay the rollout of off-payroll rules to the private sector. All potential private sector ‘employers’ need clear guidelines that are objective and easy to apply in order to get labour categorised correctly as either employed or self-employed for tax purposes for these new rules. Until such time as the guidance exists and a dispute resolution mechanism is in place, we would reiterate calls for this rollout to be delayed beyond April 2020.

In summing up its decision on control, the FTT was satisfied that Kelly was not part of the ITV jigsaw: ‘Ms Kelly was the jigsaw’. For other individuals with onerous, long running IR35 enquiries the puzzle continues. For businesses preparing for the launch of the off-payroll rules, be prepared to be puzzled! 383

The second of these cases involved the BBC’s engagement of Kay Adams as a presenter on BBC radio for two years. In the last section of the judgement, the Judge referred directly to the conclusions reached in Ackroyd. He noted that although it was not necessary, for the purposes of reaching his conclusion, to distinguish between the two cases, there were significant differences.

We note that the conclusion we have reached in relation to Ms Adams is different from the conclusion which was reached in relation to Ms Christa Ackroyd by a differently-constituted First-tier Tribunal in Ackroyd.

Strictly, it is not necessary for us to distinguish the facts in the two cases because:

(a) as we have already noted … another decision of the First-tier Tribunal is not binding on us; and

(b) in any event, as we have noted generally in the course of this decision, each case involves a value judgment and, particularly given the approach to the issue outlined by Mummery J in Hall,384 it is inevitable that different people may come to different conclusions on the same facts.

Notwithstanding the above, we believe that there are significant differences in the facts of the two cases which are material in this context.

First, in Ackroyd, the contract between the BBC and Ms Ackroyd’s service company was 7 years’ long and it followed a contract which was 5 years’ long. In contrast, each contract in this case was for approximately 1 year.

Secondly, the ratio of Ms Ackroyd’s non-BBC income to Ms Ackroyd’s BBC income was materially different from the

382 “TV star Lorraine Kelly wins tax case against HMRC”, Financial Times, 21 March 2019
383 “HMRC’s defeat in Albatel: the IR35 puzzle”, Tax Journal, 26 April 2019
384 The case, cited above, is Hall v Lorimer [1994] 66TC34. The approach, as summarised in Atholl House, is that, “the relevant court or tribunal must eschew the purely mechanical exercise of running through items on a checklist and instead stand back and make an informed, considered, qualitative appreciation of the whole” (para 37).
comparable ratio in relation to Ms Adams. Ms Ackroyd’s non-BBC income was effectively de minimis. For example, the First-tier Tribunal in Ackroyd noted that, in the calendar years ending 31 December 2009 and 31 December 2010, Ms Ackroyd’s BBC income amounted to 98% and 96.5%, respectively, of her aggregate gross income. These figures are some way north of the equivalent figures in relation to Ms Adams.

Thirdly, Ms Ackroyd was given a clothing allowance whereas no such allowance was made to Ms Adams.

Forthly, the First-tier Tribunal in Ackroyd found as a fact that the BBC had first call on Ms Ackroyd’s time, that Ms Ackroyd attended BBC training sessions and that Ms Ackroyd could be told by the BBC whom she was interviewing. None of these features was present in the relationship between the BBC and Ms Adams.

Finally, Ms Ackroyd was required to obtain the consent of the BBC for her non-BBC engagements whereas we have found as a fact that, notwithstanding the terms of each written agreement in this case, each actual agreement between the BBC and the Appellant (and, hence, each hypothetical contract between the BBC and Ms Adams) did not require Ms Adams to seek the consent of the BBC before accepting other engagements.

For the above reasons, we consider that there are grounds for believing that the First-tier Tribunal in Ackroyd might well have reached the same conclusion in that case as we have done in this case if they had been presented with the facts in this case.385

Some weeks after the Atholl House judgement, Alastair Kendrick wrote a piece on a number of persistent misunderstandings about IR35, including the view held by some that HMRC’s recent record in losing IR35 cases meant “I have nothing to worry about”:

What the recent cases show is the complexity of the rules and how a decision can be made based on a particular clause within a contract. It would be foolish to assume that HMRC is always wrong in its approach. I am sure we will see more cases proceed through the courts and those judgments will give greater clarity to HMRC, advisers and judges in the first tier tribunal.

A lot of the recent decisions have been in regard to radio and TV presenters, and the judgment seems to hinge around the extent of control exercised upon them by the broadcaster. In my experience, there will be a considerable difference over the way a news or sports presenter will work compared to, say, someone doing a general radio show. A number of the cases which have recently been taken before tribunal are of presenters who fall in the latter category.386

In September the linked cases of three other BBC presenters was decided by the FTT, ruling once again that IR35 applied in the arrangements concluded by their respective PSCs and the BBC.387 Without going into the details of the case, it provides another illustration of the practical problems with determinations in this area. In a commentary on the case in Taxation, Waqar Shah (Mishcon de Reya LLP) highlighted that the fact that the chair of the panel, Judge Harriet

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386 “Five misunderstandings about IR35”, AccountingWeb.co.uk, 16 July 2019
387 Paya Limited, Allday Media Limited & Tim Wilcox Limited v HMRC [2019] UKFTT 0583 (TC)
Morgan had had to use their casting vote, as the tribunal had not reached a unanimous decision, despite the length of judgement: all 177 pages. Mr Shah also noted comments made by a senior HMRC officer, Mr Dixon, in a meeting with the BBC in September 2012: apparently Mr Dixon “advised those he trained on this area that they would be competent after three years and understand it after five years.”\footnote{The FTFT has also ruled that IR35 applied in a fourth case, involving Eamonn Holmes presenting ITV’s This Morning.\footnote{Breaking news: FTT in Paya Ltd and the application of the IR35 legislation”, \textit{Taxation}, 24 October 2019. For this comment see, Paya Limited [2019] UKFTT 0583 (TC) para 396}} The FTT has also ruled that IR35 applied in a fourth case, involving Eamonn Holmes presenting ITV’s This Morning.\footnote{Devereux press notice, \textit{IR35 applies to Eamonn Holmes’ work on This Morning}, 25 February 2020. see, Red, White and Green Limited [2017] UKFTT 03624 (TC)}

In October 2018 the Upper Tribunal upheld the decision of the FTT in the \textit{Ackroyd} case, in favour of HMRC.\footnote{Christa Ackroyd Media Ltd v HMRC [2019] UKUT 0326 (TCC)} Taxation editor Andrew Hubbard observed, “the decision here emphasises yet again that there is no generic answer to any IR35 dispute and that every case depends entirely on its own facts.” Mr Hubbard went on to suggest the Tribunal’s analysis “highlights the real difficulties faced by engagers under the new off-payroll working environment … it is no wonder that many large organisations have simply adopted a blanket approach and refused to engage with personal service companies at all.”\footnote{“Broadcaster’s services provided through a personal service company”, \textit{Taxation}, 30 October 2019} In the \textit{Tax Journal}, Gillian Murdoch & Jeremy Edwards (Baker & McKenzie) argued that despite the value of the Tribunal’s consideration of the ‘control test’ – that is, whether under the hypothetical contract the BBC had sufficient ‘control’ of Ms Ackroyd to establish a relationship of employment – “the test for IR35 remains nuanced and far from clear cut in many cases.”\footnote{“HMRC wins in Upper Tribunal on IR35”, \textit{Tax Journal}, 7 November 2019; see also, “Ackroyd Media: a controlling decision?”, \textit{Tax Journal}, 6 December 2019. For another recent UTT case see, Kickabout Productions Ltd [2020] UKUT 0216 (TCC).}

8.5 Technical consultation on implementation (March 2019)

On 4 March 2019 Treasury Minister Mel Stride made a statement to the House on tax avoidance, evasion and compliance, and as part of this, announced HMRC’s further consultation:

In April 2017, the Government introduced new rules for public sector organisations who take on contractors through their own company. The reform means that public sector organisations are now responsible for deciding both whether the contractor is acting as an employee, and therefore within the rules, and ensuring the right amount of tax is paid.

I am pleased to report to the House that this has proved to be effective, with HMRC estimating that an additional £550 million has been raised in income tax and national insurance contributions in the first 12 months since the measure was introduced. However, non-compliance in the private sector...
remains a persistent and growing problem that, if left unchecked, will cost the taxpayer as much as £1.3 billion by 2022-23, according to the Government’s estimates.

In last year’s Budget, the Government announced that we will extend the reform of off-payroll working rules to the private sector from April 2020, and tomorrow we will publish a consultation to seek views on the detailed design of the reform to enable effective implementation.

By changing the design of the off-payroll working rules, we are helping individuals working in this way to ensure that they are compliant with the existing legislation. For this reason, the Government’s focus will be on supporting organisations and businesses to apply the rules, rather than enforcing historical cases. Our aim is to provide individuals and businesses with greater certainty around how the off-payroll working rules will operate from April 2020 and the actions that individuals and businesses can take to prepare for the reform.

HMRC’s consultation paper was published the following day; responses were invited by 28 May. The consultation document underlined the point that the consultation was “not intended to consider alternative approaches to tackling non-compliance with the off-payroll working rules” and that “the reform will come into force from 6 April 2020.”

The paper set out detailed proposals in a number of areas: the scope of the exemption for the smallest organisations; determining responsibilities through the labour supply chain – for the client, agency or agencies, fee-payer, PSCs and worker; helping organisations to make the right status determination; and, providing education and support. In the latter case, the paper acknowledged criticisms that had been made of CEST, and specifically the tool’s ability to “take account of existing employment status for tax case law and the resulting possibility to not give an accurate employment status determination in some cases”, and, “reflect the complex nature of the private sector.” In response to this, the paper stated that HMRC were looking to:

- enhance the service to help customers make employment status decisions;
- improve CEST guidance so organisations can confidently make employment status determinations that people working through intermediaries will be able to see and understand
- develop an education and support package for those affected to help them prepare for, and implement changes to the off-payroll working rules.

The paper also set out a number of actions that it recommended that organisations should take, if they thought they would be affected:

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393 HC Deb 4 March 2019 cc736-7. See also, “Business attacks plan to extend tax rules for self-employed”, Financial Times, 5 March 2019


395 op.cit. p24
1. Identify and review their current engagements with intermediaries, including PSCs and agencies that supply labour to them.

2. Review current arrangements for the use of contingent labour, particularly within the organisation functions that are more likely to engage off-payroll workers.

3. Put in place comprehensive, joined-up processes (assess roles from a procurement, HR, tax and line management perspective) to get consistent decisions about the employment status of the people they engage.

4. Review internal systems, such as payroll software, process maps, HR and onboarding policies to see if they need to make any changes.

Writing in *Taxation* the editor, Andrew Hubbard, noted that the consultation had recognised that quite often workers were engaged through a long supply chain, which is why there should be statutory requirements for information to be shared, to ensure proper compliance with IR35. He raised concerns about the administrative burden of exempting small businesses, but went on to make the general point: “I can’t help thinking that, had the government stuck to its original proposals 20 years ago … we could have been spared so much of the confusion and muddle.”

In a second piece Mark Morton (Mercia Group Ltd) argued that “there appears no acknowledgement that the public sector rules have been widely misapplied and misunderstood, HMRC’s guidance on this whole area is out of date and overly-simplistic and what is really required is a blank page.”

On 12 March Ged Killen MP made an application to the Backbench Committee for a debate on these proposals; part of Mr Killen’s comments are copied below:

In principle, the reforms are trying to tackle tax avoidance in the form of disguised employment, with which I am by no means in disagreement, but the people who have contacted me are often genuinely freelance workers …

A range of issues have been brought to my attention by other signatories of the application, including concerns about the fact that people will be treated as employees for tax purposes but will not enjoy the employment rights that go along with that.

Also, the “check employment status” tool is considered by many contractors as ineffective in determining a person’s employee status, and there is the likelihood, which we have seen in the public sector already, that in the private sector companies will seek to take a blanket approach in order to avoid falling foul of the rules, which will mean that people end up being treated as employees when they really shouldn’t be, and that can lead to a recruitment crisis …

I know that the Government is currently consulting on the changes … and this would be a good opportunity for people to

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397 “Condoc on off-payroll rules for the private sector”, *Taxation*, 14 March 2019

raise the various concerns that have been brought to them by their constituents.\(^{399}\)

Mr Killen reiterated these concerns when the House debated the issue in Westminster Hall on 4 April.\(^{400}\) He also asked if the Minister could “provide a further update on the use of the IR35 rules in the public sector”, “summarise the key lessons the Government have learned from the public sector roll-out” and “give an update on how the IR35 rules sit in the Government’s wider consideration of the recommendations of the Taylor review.”\(^ {401}\) Speaking for the Opposition Anneliese Dodds also raised concerns about the state of play regarding the Taylor Review’s recommendations and argued that there should be a review of the law underpinning employment status:

There is a problem, but at the root of it is the gap between how work is characterised for tax purposes and how it is characterised for the purposes of employment legislation … The lack of clarity over the implementation of Taylor where it is warranted is leading to a huge number of problems, including the ones we have talked about, for genuinely self-employed contractors and for what we might call bogusly self-employed contractors, as well as for their employers, as they adapt to coverage by IR35, knowing that even the IR35 rules may be subject to change because of future alterations to employment law in the wake of the Taylor review.

It looks as though we will not see an immediate change, so HMRC is engaging in a process of what I call bricolage to try to bridge the gap, and the consequences are complicated and very confusing … The Government need to look at the issue at a legislative level, rather than the onus being on HMRC to try to deal with it in a technical and procedural manner … My party has said that we need a proper commission to look at it in detail, to modernise the law around employment status and to look at how it interrelates with tax status.\(^ {402}\)

In response Treasury Minister John Glen gave some details of the changes to be made to HMRC’s ‘CEST’ tool …

To support organisations in applying the rules, HMRC will continue to review and improve CEST. HMRC has already held user research sessions, and will continue to work with stakeholders over the coming months to ensure that the tool and the wider guidance suit the needs of all sectors, and to address specific points raised during the consultation.

Enhancements will be tested and rolled out before the reforms are introduced in 2020. I asked officials for greater clarity on what that is likely to mean, and we are talking about improved guidance, better phraseology and improved language that gives greater certainty to individuals who make inquiries.\(^ {403}\)

… noted the proposals for dispute resolution under the new regime where parties cannot agree status determinations …

Having listened to people’s concerns, we included proposals in our recently published consultation to help to ensure that

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\(^{399}\) Backbench Business Committee, *Representations: Backbench Debates*, 12 March 2019 Q1

\(^{400}\) HC Deb 4 April 2019 cc476-96WH

\(^{401}\) op.cit. c479WH

\(^{402}\) op.cit. cc488-90WH

\(^{403}\) op.cit. c492WH. See also PQ268953, 3 July 2019 & PQ277599, 23 July 2019
processes are put in place for individuals to resolve disputes with their engagers directly and in real time. The proposals would put a legal requirement on engagers to have a status disagreement process in place, and would require them to consider evidence provided by an individual contractor and review their status determinations accordingly.

HMRC is committed to working with organisations to ensure they make the correct status determinations, and will publish detailed support and guidance to help organisations prepare well ahead of April 2020. 404

... and said a little on the issue of contractors’ employment rights, and the Taylor Review’s recommendations for aligning employment status across tax and employment law:

I turn now to employment rights, which the hon. Member for Oxford East (Anneliese Dodds) mentioned … Falling within the off-payroll working tax rules does not currently change an individual’s status for employment rights, as there is currently no direct link between employment taxes and those rights.

The Matthew Taylor review took place in summer 2017, and the good work plan was published in December 2018. As set out in that plan, the Government agree that reducing the differences between the tax and rights frameworks for employment status to a minimum is the right ambition. We will bring forward detailed proposals this year—I recognise the need for this to happen quickly—for how those frameworks could be aligned. In the meantime, it is right that the Government take action to improve compliance with existing rules. 405

Subsequently Mr Killen tabled an EDM on 13 May critical of the Government’s proposed reform to the IR35 rules, on the grounds that it “could damage the UK’s flexible workforce, reducing avenues for work and harm the economy”, notes “concerns that the CEST routinely does not provide clear answers and raises concerns that there could be a blanket application of the rules due to the poor performance of this tool”, and “calls upon the Government to offer assurances and commit resources so that companies in the private sector have support if the IR35 rules are extended; and calls on the Government to scrap the roll-out of Off-Payroll to the private sector if assurances cannot be given and look again at reviewing the tax system to better support contingent workers.” 39 Members signed this. 406

A number of stakeholders published the submissions they made to the Government’s technical consultation. 407

In their case the CIOT argued that CEST “needs to be significantly improved if the rollout of the off-payroll working rules to the private sector is not to lead to uncertainty and protracted disputes”, noting recent tribunal decisions – including Albatel and Atholl House – where HMRC’s position on employment status had not been upheld. 408
CIOT also suggested that the exemption for small organisations should be extend to the public sector “to ensure a level playing field”, and that HMRC should review the operation of these rules:

[We recommend] that a review is undertaken … in, say, mid-2022, after a full tax year (2020/21) of operating the new rules in the private sector and with the submission deadline (31 January 2022) for self-assessment returns for that year having passed. This would provide the opportunity to assess what is working well, what is working less well and whether or not changes are needed to ensure that the process works as effectively and efficiently as it can for businesses, contractors, agencies and indeed HMRC.”

Finally the CIOT expressed particular concerns as to the proposed approach in addressing non-compliance, in cases where HMRC did not receive the tax due on a specific engagement. The consultation proposed that in this scenario, “the liability should initially rest with the party that has failed to fulfil its obligations, until such a time that it did meet those obligations”:

This means that liability would move down the labour supply chain as each party fulfils its obligations. For example, if an agency in the chain failed to send on the determination that agency would be liable for any income tax and NICs due. Similarly, if a fee-payer, having received the determination failed to make deductions from any payments made to the worker’s PSC then it would become liable.

If HMRC were unable to collect the outstanding liability from that party, for example, because it ceased to exist, the government proposes that the liability should transfer back to the first party or agency in the chain.

Where HMRC could not collect from the first party or agency it would ultimately seek payment from the client. This approach mirrors the approach taken in the agencies legislation and the legislation which applies to labour supply chains which feature non-UK employers …

Illustration B : Liability flows down the labour supply chain as each party fulfils its obligations. Liability initially rests with party that has failed to fulfil its obligations, then transfers to Agency 1 and ultimately transfers to the client where HMRC cannot collect from Agency 1.
The advantages of this approach are that it would provide a clear incentive for all parties to comply with their obligations and to ensure a determination is passed fully down the chain. This approach would also encourage all parties to contract with reputable and compliant firms.\footnote{HMRC, \textit{Off-payroll working rules from April 2020: policy paper & consultation document}, March 2019 pp14-15}

The CIOT took the view that this was 'not fair and proportionate':

We would question why, for example, if a fee-payer ceases to exist having not accounted for PAYE and NICs the first party in the supply chain should automatically be responsible? If that party has used all reasonable endeavours to ensure the integrity of the supply chain but, for example, for some reason, the fee-payer goes insolvent and HMRC is unable to recover the PAYE and NICs this does not appear to us to be a fair and proportionate response.

Similarly, where the first agency cannot pay, we do not see why the end client should become liable where the end client has done its best to ensure compliance. We consider that, as a minimum the first agency and the end client should be able to offer a defence of having taken reasonable care in these circumstances…

We note that transfer of liability to the end client is not the approach taken in the agency workers legislation, except in circumstances where the end client provides the agency with a fraudulent document stating that there is no supervision, direction or control when this is not correct (see \textit{Income Tax (Earnings \\& Pensions) Act (ITEPA) 2003}, section 44(4)).

It is true that ITEPA 2003, section 689(1B) – which addresses employees of a non-UK employer, agencies, etc – provides that where an agency is onshore but sub-contracts to an agency offshore for the supply of employees to the end client, the onshore agency is responsible for accounting for any PAYE/NICs. However, this is different because the onshore entity knows this \textit{upfront} and can comply accordingly.\footnote{CIOT, \textit{Off-payroll working rules from April 2020 - CIOT comments}, 28 May 2019 para 4.28, 4.32}

In their submission the ATT mentioned this, and expressed concerns that “the proposed rules may encourage end-user clients (the engager to whom a worker provides services) to make blanket decisions to classify
workers as employees for the purposes of tax, without properly considering all the factors that are relevant to the particular contract.”  

On the question of transferring liability the ATT noted, “the first agency may not be aware of the identity or even existence of the failing party and it seems inappropriate to impose liability on them when they have fulfilled their own obligations and carried out appropriate checks on the party they have directly engaged with”:

We would also note that perfectly legitimate businesses can close down or be unable to meet their obligations due to factors outside their control (for example the death or severe illness of a key director or staff member or the loss of a major client), which it would be practically impossible for clients to pick up as part of assurance procedures …

If liability is to be transferred, then there will need to be both guidance as to what is considered sufficient due diligence and a right of appeal against the transfer for parties which have undertaken sufficient due diligence. From a practical perspective, we are unclear what HMRC would consider reasonable due diligence. Clear and comprehensive guidance will be required.

In their submission the ICAEW agreed with these concerns:

Illustration B in the consultation document proposes that the liability should move down the chain as each party fulfils its obligations, with liability ultimately resting with the end client if other parties fail. We are concerned that this approach could result in an innocent party having an unexpected liability. It relies on smooth communication flows throughout, possibly quite long, supply chains and it would be impractical for HMRC to police this…

We do not believe that it is reasonable for the end client to become liable where they have taken reasonable care to ensure they engage with only reputable third parties. … Equally we do not believe it would be fair that a contractor who has had tax withheld, but that tax has not been paid to HMRC by the fee payer, to be liable for the tax not paid over …

We do, however, believe that if the fee payer and the contractor contrive not to withhold tax when a determination has been made that tax should be withheld, the contractor should not be able to escape any liability for the tax not withheld. This appears to be a weakness in the current proposals.

The ICAEW argued that April 2020 was too soon for implementation, that the definition of ‘small organisations’ was too complicated, and that there should be a real-time independent statutory method of appeal, allowing workers to dispute the assessment made by their client organisation. More widely, the ICAEW suggested that the Government should address “three interdependent policy issues … which are fundamental to this consultation”:

(a) The tax, NIC and legal status of work should be the same, it should be certain, and the consequences should be comprehensible to the engager and worker. There are a number

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412 ATT press notice, *Off-Payroll proposals need rethink, says ATT*, 31 May 2019

413 ATT, *Off-payroll working rules from 2020*, May 2019 para 3.15-6, 3.18

414 ICAEW, *Off-payroll working rules from April 2020 (ICAEW representation 54/19)*, 23 May 2019 para 36
of possible options to explore which would achieve this and these must be considered in conjunction with employment rights to arrive at a balanced and coherent position …

b) Work should be taxed in the same way, regardless of the wrapper or status. While we understand that government policy appears to be to provide an incentive for those in self-employment (via lower rates of tax and NIC), we believe there should be a debate about how much such an incentive should be and how it should be targeted. … We strongly believe that addressing the differential would be the most robust long-term way to restore equilibrium of workers’ employment status in the jobs market and to protect Exchequer revenues.

c) Off-payroll working in the public and private sectors should be taxed in the same way. Having different tax rules is unsustainable in the longer term, leading to greater complexity, unfairness, a greater administrative burden and the likelihood of more mistakes and ultimately non-compliance. However, the changes introduced in 2017 for the public sector are continuing to cause problems and these must be resolved before the same system is extended to the private sector.

In their submission the Law Society argued that as the proposals as they stand would be “problematic in practice”, and made four suggestions for changes:

Whilst exclusions for small companies and equivalent “small” non-corporate clients are welcome, the proposals will benefit from additional specific exclusions. We suggest:

- that a person should not be liable for tax if appropriate procedures and systems are in place and are followed in relation to status determination; and
- ideally, it should be possible to obtain an advance ruling from HMRC that can be relied upon; or
- if a system of advance rulings is not possible then perhaps the on-line Check Employment Status for Tax (CEST) service could be used, although additional investment would be required to ensure that this tool is fit for the purpose; or
- a system of registration for gross payment for compliant taxpayers could be introduced. Both of the non-resident landlord scheme and construction industry scheme provide useful models.

Finally, in their submission the LITRG raised a different concern: that business-to-consumer arrangements, such as a carer providing services to someone in their own home, might be affected by this reform:

We understand that the ‘small business’ exemption is going to be defined by reference to the Companies Act for corporate entities (i.e. where two of the following criteria are met: turnover of no more than £10.2 million; balance sheet of no more than £5.1 million; and/or no more than 50 employees). Small non-corporate entities look like they will have to meet an alternative test based on turnover and/or the number of employees of the organisation...

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415 op.cit. para 6
It is not clear to us whether business-to-consumer arrangements will be caught if the exemption is framed in this way. For example, where a carer provides services to a disabled individual/private householder via a PSC, we assume that it should fall outside the scope of these changes. However, the continued reference to the end clients being incorporated/unincorporated small ‘organisations’, is confusing. An individual is, after all, not an organisation, but could easily have regular arrangements with a trader who operates through a company. Other examples would include gardeners or nannies. The government and HMRC must make it clear that such situations are not affected.417

LITRG also raised concerns as to the practical consequences of this reform for those on low-incomes who work through PSCs largely or wholly at the behest of their engager:

Many low-income workers often find that they are offered work in the private sector on the basis that they will structure their work through a PSC. This can help save tax/NIC for both them and their engagers. With the tax/NIC ‘advantage’ gone, it is likely that many workers will be pulled out of PSCs by their engagers. This has two potentially serious ramifications for the worker.

Firstly, depending on whether the PSC is closed down correctly, the worker could be left with messy limited company and corporation tax compliance issues that they do not understand and that could follow them around for years. We would therefore like to see HMRC working with Companies House to come up with a way of making it as easy as possible for taxpayers to close down PSCs themselves in conjunction with an amnesty for any accrued penalties.

Secondly, workers could be put into potentially non-compliant umbrella arrangements, which should be a significant concern to the government. Indeed, one of the outcomes of the public sector changes418 was a mass shift of contractors (often unwittingly) into highly aggressive umbrella models, including ones based on loan arrangements …

Thus, unless HMRC take action to close down non-compliant umbrella companies before the private sector changes come in, vulnerable workers could end up in exploitative working arrangements. Moreover, some of the £1.3 billion per year IR35 losses that the government is hoping to secure may not materialise, as existing arrangements might just be displaced by other, different types of tax avoidance.419

8.6 Draft Finance Bill 2019 (July 2019)

On 11 July the Government published draft legislation to be included in the Finance Bill, including provisions to reform the off-payroll working rules; as part of a written statement on the draft Bill, Treasury Minister Jesse Norman, summarised the outcome of the consultation:

Off-payroll working rules from April 2020

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417 LITRG, HMRC consultation: Off-payroll working in the private sector, 29 May 2019 para 4.4, 4.7-8. See also, LITRG press notice, Off-payroll working in the private sector, 29 May 2019
418 See for example, Nurses & agencies using umbrella loan schemes risk tax bills and prosecution’, Contractor Calculator.co.uk, 1 February 2018
419 LITRG, HM Revenue & Customs (HMRC) consultation: Off-payroll working in the private sector, 29 May 2019 paras 1.8-11
The government has previously announced that it will improve compliance with the off-payroll working rules in all sectors by bringing them into line with the public sector from April 2020. The reform will make organisations responsible for determining whether the existing rules apply to the contractors they hire and ensuring the necessary employment taxes are paid. As announced at Budget 2018, outside the public sector, this change will only apply to medium and large-sized organisations.

The draft legislation makes clear when non-public sector organisations, including unincorporated organisations, will be considered to be small and therefore not within the scope of the reform. The draft legislation also includes provisions to ensure that all parties in the labour supply chain are aware of the organisation’s decision and the reasons for that decision, and will introduce a statutory, client-led status disagreement process to allow individuals and fee-payers to challenge the organisation’s determinations.\footnote{Written statement - HCWS1713, 11 July 2019}

The Treasury published a summary factsheet on this reform, which addressed a number of ‘key concerns’ raised by stakeholders:

Since the introduction of the public sector reform, and during consultations, the Government has listened to the views of stakeholders. On the basis of their feedback, it can confirm:

- **The reform is not retrospective.** As was the case in the public sector, HMRC will focus on ensuring businesses comply with the reform for new engagements, rather than focusing on historic cases.

- **HMRC will not carry out targeted campaigns** into previous years when individuals start paying employment taxes under IR35 for the first time. Organisations’ decisions about whether workers are within the rules will not automatically trigger an enquiry into earlier years.

- The reform will not stop anyone working through a company if that suits them.

- HMRC will provide **extensive support and guidance** to help organisations implement the off-payroll working rules to ensure they apply them correctly. This will include the publication of detailed guidance for organisations and both general and targeted education packages, including webinars, workshops and one-to-one sessions with businesses in particular sectors.

- HMRC continues to work with stakeholders to make **improvements to CEST** and wider guidance. Enhancements will be rigorously tested with stakeholders, and operational and legal experts, and will be available for use later in 2019.

- The vast majority of decisions in the public sector are made on a case-by-case basis, and the new **client-led status disagreement process** will allow the organisation’s decision to be challenged in real time.\footnote{HM Treasury, *Off-payroll working rules from April 2020: Factsheet*, July 2019 para 7}
Legislation will be introduced in Finance Bill 2019 to amend the
Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003) and
relevant National Insurance contributions regulations, so that
where an individual works for a medium or large-sized engagers
outside of the public sector, through their own PSC and falls
within the rules:

- the party paying the worker’s PSC (the ‘fee-payer’) is
treated as an employer for the purposes of Income Tax and
Class 1 National Insurance contributions
- the amount paid to the worker’s intermediary for the
worker’s services is deemed to be a payment of
employment income, or of earnings for Class 1 National
Insurance contributions for that worker
- the party paying the worker’s intermediary (the ‘fee-payer’)
is liable for secondary Class 1 National Insurance
contributions and must deduct tax and National Insurance
contributions from the payments they make to the worker’s
intermediary in respect of the services of the worker
- the person deemed to be the employer for tax purposes is
obliged to remit payments to HMRC and to send HMRC
information about the payments using Real Time
Information (RTI).

… and details of HMRC’s assessment of the impact this would have on
individuals, households and families …

This measure is expected to impact 170,000 individuals working
through their own company, who would be employed if engaged
directly. Those who are complying with the existing rules should
feel little impact. The measure is targeted at individuals who are
not compliant with the current rules. These individuals will be
required to pay tax at the correct levels and will therefore face
additional tax liabilities. For individuals who were previously non-
compliant, adhering to the off-payroll working rules could have an
impact on the disposable income available to them and their
families.

… and on businesses:422

Due to the scope of the off-payroll working rules and the degree
of change required by this reform, the impact on business and
civil society organisations is expected to be significant but varied,
with some realising savings through reduced administrative
requirements.

PSCs : There will be on-going savings for around
230,000 PSCs who will no longer have the requirement for
determining status or associated accounting burdens.

Engager organisations : Up to 60,000 engager organisations
outside the public sector are in scope of the reformed off-payroll
working rules. The majority of large organisations, and a high
proportion of medium-sized organisations, who engage off-
payroll workers do so through agencies. One-off costs could
include familiarisation with the changes, upskilling staff in making
status determinations and determining whether the rules apply to
their existing off-payroll engagements. Ongoing costs could

422 HMRC, *Rules for off-payroll working from April 2020: tax information & impact
note*, 11 July 2019. HMRC’s estimates of the Exchequer impact of this measure were
unchanged from the 2018 Budget.
include making status determinations for any new off-payroll engagements and maintaining a status disagreement process for off-payroll workers who seek to challenge their status determination.

Organisations that engage PSCs directly will be additionally responsible for deducting tax and National Insurance contributions and remitting it directly to HMRC for these engagements through RTI.

**Recruitment agencies**: This measure affects approximately 20,000 agencies who provide workers to medium and large-sized organisations. They will need to operate payroll for any workers they supply who work through their own company and fall within the scope of the rules. One-off costs could include familiarisation with the changes, upskilling staff, making IT changes and implementing processes that allow them to operate payroll on the payments made to PSCs. Ongoing costs for these agencies could include accounting for and reporting the PAYE liabilities through RTI. …

**Estimated one-off impact on administrative burden (£m)**

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**Estimated on-going annual impact on administrative burden (£m)**

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HMRC also published a summary of the responses it had received to the consultation, and the Government’s response to these. HMRC had received ‘over 200’ written responses from a ‘a range of stakeholders including individuals, client organisations, accountants, lawyers, tax advisors and representative bodies.’ As noted, the consultation set out proposals to address four key issues:

- The scope of the reform and the definition of small business;
- How to ensure parties in the labour supply chain have the information they need to comply with the reform;
- How HMRC should address non-compliance in the labour supply chain; and
- How to address concerns about clients making blanket determinations and giving workers and fee-payers the power to challenge status determinations made by client organisations.

On the scope of reform, respondents agreed with using the Companies Act tests for excluding small businesses. In light of concerns that the tests for unincorporated organisations were too complex, the

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424 op. cit. para 1.9
Government has proposed a single turnover test: unincorporated organisations with an annual turnover under £10.2m would be exempt.

On information requirements, in the light of responses the Government has proposed that information on a worker’s status determination will cascade down the labour supply chain. Initially the Government had suggested a second option where the client provided this information direct to the fee-payer: 425

Based on stakeholder responses, evidence suggests that labour supply chains are generally robust and information can be passed through effectively. The government will therefore legislate to require clients to pass the status determination and reasons for the determination down the contractual chain together, as well as passing them directly to the worker.

The government is not pursuing the simplified information flow due to practical difficulties associated with the client identifying the fee-payer which were raised by respondents ...

**Flow of information through the labour supply chain**

There were a variety of views on the Government’s proposal to deal with non-compliance, and whether it was proportionate for clients to face a potential tax bill due to failures at other stages of the labour supply chain:

While respondents recognised the need for these organisations to carry out due diligence on labour supply chains, there were concerns that genuine business failures and administrative errors, resulting in an unpaid PAYE liability, could mean the client or agency at the top of the chain is left with unpaid PAYE liabilities despite having taken reasonable care. 426

In response the Government stated that “the proposals are not intended to transfer liabilities in cases of genuine business failure, where deliberate tax avoidance has not occurred“:

Draft legislation will set out conditions under which the liability may be transferred to the top parties in the labour supply chain. Supporting guidance will clarify the steps HMRC expect clients

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425  *op. cit.* p11
426  *op. cit.* para 1.20
and agencies at the top of the supply chain to demonstrate they have exercised reasonable care. 427

The response document gives more details as to the Government’s reasons for retaining these provisions: 428

It is appropriate for organisations that have most control over the labour supply chain to take steps to drive up compliance. In addition, unlike the client, a primary function of the first agency’s role is to supply labour services, and the government therefore considers the first agency to be best placed to improve compliance further down the contractual chain. The client is similarly able to influence compliance in its choice of the first agency in the contractual chain.

The government believes transferring tax and NICs liabilities where there has been non-compliance in the labour supply chain and where it is not possible to secure the tax liability from the non-compliant entity to the first agency and then to the client, will incentivise all parties in the labour supply chain to take steps to apply the rules as intended. …

The government understands there are commercial circumstances in which longer supply chains are common. HMRC is working with stakeholders to better understand these arrangements and to provide appropriate guidance and support to organisations implementing the reforms in these circumstances.

The government recognises there are circumstances in which an otherwise compliant labour supply chain could break down, resulting in an unpaid tax liability. The transfer of liability provisions are intended to be used in circumstances in which, for example, a promoter of tax avoidance has entered into the labour supply chain. The government will legislate in line with the consultation proposals and HMRC will make clear in guidance the circumstances in which it will not seek unpaid liabilities from parties further up the labour supply chain. HMRC’s guidance will also advise organisations on steps they can take to help ensure due diligence of their internal processes.

Transfer of liability across the labour supply chain

Finally, on the issue of status determinations, several stakeholders suggested there was a significant risk of clients making 'blanket'

427  op. cit. para 1.21
428  op. cit. p14
determinations, and argued for an HMRC-led status disagreement process.

The Government has proposed statutory provision to underpin a client-led process, on the grounds that a client would be “best able to understand the contractual terms and working practices of those it engages” and “best placed to provide responses in real time”:

No evidence was provided in this consultation to support the suggestion that blanket determinations will be a particular problem in the private and third sectors … The vast majority of medium and large-sized organisations will have HR or procurement functions that will be able to make employment status determinations for those engaged through PSCs. There are clear incentives for them to make accurate determinations where someone is likely to fall outside of the off-payroll working rules.

However, several respondents remained concerned about the possibility of blanket determinations. The government believes it is important to listen to these concerns and look to address them in a proportionate way.

For this reason the government will legislate to set out the minimum requirements for the ‘status disagreement process’ in legislation to ensure workers can expect the same treatment regardless of which client they engage with.

This will require clients to respond to representations made by off-payroll workers that disagree with their status determination. Failure to respond to representations made by the fee-payer or worker will result in the client being liable for the tax and NICs liabilities. To support clients, HMRC will set out in guidance how a client can fulfil its obligation to take reasonable care and how it might implement the status disagreement process …

Compliance teams will continue to work directly with a range of organisations providing extensive support and guidance to help implement changes ahead of April 2020. This will include providing relevant information to those who will need to apply the off-payroll working rules, such as: HR directors, hiring managers.429

The response document also underlined HMRC’s ongoing work to improve CEST:

HMRC has conducted over 25 CEST user research sessions and continues to work with a wide range of stakeholders on its enhancement of the service. HMRC expects to make the service available before the reform is implemented.

There has been some comment on the outcome of this second consultation.

For their part the CIOT reiterated their view that the reform would only work well if CEST was significantly improved:

Colin Ben-Nathan, Chair of CIOT’s Employment Taxes Subcommittee, said: “If businesses are to make the correct decisions on whether the off-payroll rules apply then CEST will need to be significantly improved … Businesses are already making decisions on contracts and projects [and] … need to know urgently how those contracts will be taxed from April 2020. So we think that

429 op.cit. para 1.24, p16, para 1.29
the improved CEST tool needs to be ready by October 2019 at the latest so that new and existing contracts can be reviewed by April 2020.

Until CEST takes proper account of mutuality of obligation, multiple engagements, contractual benefits - such as holiday pay, maternity/paternity pay - and whether someone is in business on their own account, it is unlikely it will be able to reach the right decision on status. And this is key because otherwise the lack of confidence in CEST will increase disputes between businesses and contractors and so lead to significant time and effort having to be expended by businesses, contractors, HMRC and the courts in trying to resolve them.”

Mr Benn-Nathan also raised specific concerns about the draft provisions…

“We welcome the Government’s confirmation that small private sector entities will be excluded from the off-payroll working rules, although we are disappointed that the Government has not extended the exclusion to small public sector entities to ensure a level-playing field. We also suggested the Government re-consider how employee numbers are to be calculated in the small entity test… For incorporated companies the Companies Act tests will be used and this includes the employee numbers test. We think it would be unfortunate if this test affected the behaviour of some small companies by discouraging them from taking on part-time employees in order to retain their ‘small’ status.

“We also remain concerned by the transfer of liability provisions … We agree that there is a need for all parties in the labour supply chain to act appropriately and diligently. However, where HMRC are unable to recover the PAYE and NICs, we think it is unfair and disproportionate for the liability to simply be transferred to the top agency/end client … We think the Government should legislate along the same lines as applies for agency workers where liability for PAYE is only transferred in very narrowly defined circumstances.

… before making a wider point:

“Notwithstanding the draft legislation published today on implementation of the off-payroll changes in the private sector, the reality is surely that a more strategic review is required of the taxation of labour so that the differences between being taxed as an employee, as self-employed and contracting via a company are minimised or at least made clearer. Matthew Taylor’s Good Work Plan, published in July 2017, and the Government’s initial response last December represented a start but moving things forward should now be a key priority.”

For their part the ATT raised similar concerns as to CEST, and the transfer of liability provisions:

The ATT has previously expressed concerns about proposals as to from whom and how HMRC could seek to recover unpaid tax and NICs where the off-payroll rules are not applied correctly. HMRC’s proposal is that liability would initially be transferred to the first agency in the chain, and then back to the engager if required.

430 CIOT press notice, Improvements urgently needed to HMRC’s IR35 assessment tool for off-payroll working rules to operate effectively, 11 July 2019
Michael Steed, Co-chair of the ATT’s Technical Steering Group, said: “We are pleased to see HMRC indicate that these proposals are not intended to transfer liabilities in cases of genuine business failure, where deliberate tax avoidance has not occurred. But the final legislation and accompanying guidance will be key in ensuring that this is indeed the case in practice.”

Michael Steed continued: “Key to the success of these reforms will be the promised improvement to HMRC’s Check Employment Status for Tax (CEST) service, as well as the level of practical HMRC support available to affected businesses both in the run up to, and after, April 2020.”

Writing in *Taxation* the magazine’s editor, Andrew Hubbard highlighted the proposed compliance rules, noting “it is going to be vital for all those who do engage workers through a personal service company to review their processes and to be crystal clear on what their responsibilities are”:

If not, they could be hit with large unexpected tax bills. There is not long to get everything in order. The new rules will apply to payments made on or after 6 April next year: the date that the contract was entered into is irrelevant.

In a second piece reviewing the draft legislation, Susan Ball & Lee Knight (RSM) also highlighted the transfer of liability provisions:

Despite representations during the consultation process, this enables HMRC to transfer liabilities within a labour supply chain. Organisations may therefore seek to protect themselves and may look to shorten supply chains as a result.

HMRC has promised guidance on this area (expected to expand on that currently available covering supply chain due diligence) and has stated that there will be circumstances where these provisions will not apply, for example, when there is a genuine business failure such as an insolvency of an entity in the chain. This will be of interest to all parties as many end-users would prefer to be protected from unexpected liabilities by law.

As noted, it was anticipated that statutory provision for this reform would be included in the Finance Bill to be introduced after the 2019 Budget. On 14 October the then Chancellor, Sajid Javid, announced that the Budget would be on 6 November, but reversed this decision on 25 October in anticipation of a General Election, subsequently confirmed for 12 December. In response, the ATT argued implementation should be postponed for a year, as the delay left “businesses with a greatly reduced and unrealistically short time frame

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431 ATT press notice, *Changes to off-payroll rules welcome but concerns remain*, 12 July 2019
434 HM Treasury press notice, *Budget 2019: Announcement regarding the date of the Budget*, 14 October 2019
in which to adapt to the changes.”436 Although the issue has not been a major feature of the Election campaign, all of the main parties stated that they would ‘review’ the reforms to IR35.437

The Government’s position on the reform to IR35 was reiterated in a written answer in response to a series of linked PQs, some days before the House’s Dissolution on 6 November:

Asked by Jonathan Edwards : To ask the Financial Secretary to the Treasury, how HMRC established its estimate that nine out of 10 contractors are not compliant with current off-payroll working rules in the private sector.

Answered by Jesse Norman : The off-payroll working rules (sometimes known as IR35) have been in place since 2000. They are designed to ensure that individuals working like employees pay broadly the same amount of tax and National Insurance Contributions, regardless of the structure they work through. They do not affect the self-employed.

Budget 2018 announced that reforms introduced in 2017 for the public sector would be extended to all sectors, from April 2020, giving businesses time to prepare. The Government has consulted extensively on the reform and HMRC are publishing guidance as well as delivering an education and support programme.

HMRC’s estimates for non-compliance with the off-payroll working rules are based on relevant tax return data.

HMRC continue to work with stakeholders to make improvements to the Check Employment Status for Tax (CEST) digital service and wider guidance. Enhancements will be rigorously tested with stakeholders, and operational and legal experts, and will be available for use later in 2019.

HMRC have been clear that it is not correct to rule all off-payroll workers to be within or outside the rules irrespective of their contractual terms and working arrangements. On 11 July 2019, HMRC published a Tax Information and Impact Note setting out the impact on individuals, households and families of the reform in the private sector … The Government also published draft legislation on 11 July 2019 which sets out the status disagreement process that clients will need to implement in time for April 2020. HMRC have published guidance to support customers in making these changes.438

At this time HMRC published an ‘issue briefing’ on this reform, which addressed concerns from contractors that anyone who found they were covered by IR35 from the new tax year as a result of these changes would be subject to an enquiry for earlier years. Given HMRC’s estimates of the level of non-compliance with IR35, the numbers of investigations might be very large. HMRC’s briefing stated that they had “taken the decision that they will only use information resulting from these changes to open a new enquiry into earlier years if there is reason to suspect fraud or criminal behaviour.”439

436  ATT press notice, Delay controversial contractor tax rule by a year, says ATT, 30 October 2019
437  “Main parties pledge to review IR35 tax reforms after election”, Financial Times, 4 December 2019
438  PQs293521-4, 7 October 2019
439  HMRC, Reform of off-payroll working rules: issue briefing, 22 October 2019
Writing in the *Tax Journal* Dawn Register (BDO) commented that this “appears to be good news” but went on to add:

To be pedantic about HMRC’s wording, it does say that organisations’ decisions about whether workers are within IR35 will not *automatically* trigger an enquiry into early years (my emphasis added). This falls short of a guarantee of protection from such enquiries. Contractors should consider their position carefully and seek their own independent tax advice.\(^440\)

*Taxation* editor Andrew Hubbard called it a “pragmatic response to a difficult situation” which would allow “everybody to move on”, but went on to raise one concern:

I wonder whether it is right for HMRC to say that for this part of the tax system only it will ignore some information when deciding whether to open an enquiry. Why here and not in any other problematic area? There are difficult issues of public policy here that are worthy of a wider debate.\(^441\)

At the end of November 2019 HMRC released its updated version of CEST, with updated guidance in its *Employment Status Manual*.\(^442\)

*Taxation* magazine quoted Susan Ball (employer solutions tax partner at RSM) as saying, “it is understood that around 30 questions have been updated or included and that several industry bodies and reportedly more than 300 stakeholders were asked to use the new version and feed in comments.” Ms Ball went on to underline that CEST was the only device that would produce a result that HMRC would stand by, provided the information input is accurate and used in accordance with HMRC’s guidance.\(^443\) Writing for *AccountingWeb*, Rebecca Seeley-Harris (Re Legal Consulting Ltd) observed that, “there are many dissenting voices around the use of the CEST tool, but it does provide valuable evidence of what the worker needs to do to remain outside of IR35. HMRC openly states that the CEST output is its view, and as in any legal argument, there are two sides. Rightly or wrongly this is simply how HMRC sees the situation.”\(^444\)

Finally, also writing on *AccountingWeb*, Meredith McCammond from LITRG argued that the new tool was “certainly better in terms of helping hirers or workers with a general tax status query”, but that there remained “some limitations with the tool as far as low paid workers are concerned”:

The CEST tool only looks at employment status from a tax perspective, not from an employment law perspective. Usually, a person who is employed or self-employed for tax law will be employed or self-employed for employment law – but not always.

The CEST doesn’t cover “worker” status. It is therefore unfortunate that we have heard of workers being referred to use

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\(^{441}\) “A pragmatic solution but is it the right one?”, *Taxation*, 13 October 2019

\(^{442}\) *HMRC, Employment Status Manual* paras 11000-11170, ret’d February 2021

\(^{443}\) “News: Revised CEST tool launched”, *Taxation*, 27 November 2019

\(^{444}\) “IR35: HMRC updates CEST tool for off-payroll roll-out”, *AccountingWeb*, 26 November 2019
the HMRC tool in order to help them determine their employment law status …

It is simply not good enough for HMRC to advise those presenting in false self-employment arrangements to look on gov.uk, talk to their employer or complete the self-employment pages of a tax return. What those people really need is a clear pathway to support, and for HMRC to take action against their unscrupulous engagers.445

The Financial Secretary Jesse Norman summarised the changes made to CEST in answer to a PQ in January 2020:

**Asked by Sir Christopher Chope** : To ask the Chancellor of the Exchequer, what improvements have been made to the HMRC Check Employment Status for Tax (CEST) tool to ensure that it meets the needs of the private sector; and what proportion of the resulting checks will be full and accurate.

**Answered by: Jesse Norman** : The Check Employment Status for Tax (CEST) digital service was first released in March 2017. It helps customers apply the off-payroll working rules correctly. Following feedback from customers and stakeholders, HMRC released an enhanced version of the service on 25 November 2019. HMRC worked with over 300 stakeholders to identify and test the enhancements to ensure the service meets customer needs. These enhancements include making the questions and the results clearer, increasing the number of questions to provide a more thorough assessment and building in features to reduce user errors.

Improvements have also been made to language and presentation, and HMRC have added guidance to ensure questions are clearly understood. CEST is accurate. It has been tested rigorously against known case law and settled cases. HMRC stand by its results if it is used in accordance with HMRC guidance and the facts put into CEST are correct.

CEST currently provides an employment status determination for tax purposes in around 85% of uses, all bar the most complex or finely balanced cases. For these more complex cases, HMRC provide detailed guidance and dedicated support.446

More recently HMRC has published updated details of its work updating CEST, as an FOI release.447 One extract from HMRC’s summary is reproduced below, which sheds some light on how CEST has been used:

**Usage data**

- Our digital services have supported 181,914 CEST users, with 138,031 CEST users in the period 24 September 2019 to 24 November 2019, an increase of 32% in digital traffic in the period 25 November 2019 to 31 January 2020
- The completion rate has increased by 9% to 88%, indicating customers find the wording of questions easier to understand, making results more reliable

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445 "Employment status tool is good for the low paid", *AccountingWeb*, 16 December 2019
446 [PQ1678](https://www.parliament.uk/business/committees/committees-special/finance-committee/), 14 January 2020
• CEST has provided a determination in 80% of uses in the period 25 November 2019 to 31 January 2020. An individual user may produce more than one determination in one session

• CEST provides 3 outcomes for users asking if the IR35 rules apply. In the period between 25 November 2019 and 31 January 2020 the split between the outcomes was as follows:

<table>
<thead>
<tr>
<th>Category</th>
<th>Number of outcomes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Determinations Inside IR35</td>
<td>91,665</td>
</tr>
<tr>
<td>Determinations Outside IR35</td>
<td>123,924</td>
</tr>
<tr>
<td>Unable to Determine</td>
<td>56,026</td>
</tr>
<tr>
<td>Overall total</td>
<td>271,615</td>
</tr>
</tbody>
</table>

• We received 139 digital queries through the online service, an increase of 50% from the previous 2 months before the launch of the enhanced CEST tool

• The Employment Helpline has received 2,321 calls between 25 November 2019 and 31 January 2020, compared to 2,251 calls between September 2019 and the launch of the enhanced CEST tool on the 25 November 2019. This is an increase of 3.1% from the previous 2 months before the launch of the enhanced CEST tool (calls were answered in an average of 1 minute 59 seconds between 25 November 2019 and 31 January 2020)

• CEST guidance has been used by 57,958 users

• The peak use was 8,584 users on 28 January 2020, with 902 using the tool at 2pm. Current user figures demonstrate that the system is working well within capacity.\(^{448}\)

8.7 IR35 & the Independent Loan Charge Review (December 2019)

In December 2019 Sir Amyas Morse, former Comptroller and Auditor General, published an independent review of the 2019 Loan Charge – a tax charge on ‘loan schemes’, a type of highly specialised tax avoidance.\(^{449}\) Although the Loan Charge is not directly related to IR35, the review made some interesting observations on the historical impact of IR35 on the market for tax avoidance, as well as the Government’s private sector reforms.

To give a little background, over the last few years the Government has introduced several measures to tackle ‘disguised remuneration’ (DR) loan schemes – effectively a type of tax avoidance scheme where an employee or contractor is not paid directly – but by payment being made by a third party, often a trust, in the form of a loan. The aim of


these arrangements was to avoid tax being charged on the ‘loan’, which the trust would not actually seek to be repaid.

Initially legislation to counter this form of tax avoidance was introduced in 2011. However, the variety of schemes marketed and the numbers of scheme users grew strongly. HMRC faced considerable practical difficulties to track these schemes and open enquiries into the tax returns of anyone who had used a scheme – in part because there are statutory time limits which apply for HMRC to open an enquiry into someone’s tax return for a past tax year. In addition the sheer number of schemes and the ingenuity of scheme promoters in crafting and adapting their design hampered HMRC’s efforts to challenge the effectiveness of individual schemes in the courts.

In the 2016 Budget the Government confirmed that since then “new schemes have emerged which attempt to sidestep this legislation” often involving “individuals being paid in loans through structures such as offshore Employee Benefit Trusts”, and that it would introduce legislation to counter their use, including “a new charge on loans paid through disguised remuneration schemes which have not been taxed and are still outstanding on 5 April 2019.”

The Loan Charge came in from April 2019, although, as often noted by Ministers, HMRC has offered taxpayers a ‘settlement opportunity’ to settle their tax position ahead of this Charge arising. HMRC have estimated that around 50,000 individuals used loan schemes over this time, and that the package of changes announced in the 2016 Budget to tackle their use would raise £3.2 billion.

The Loan Charge has proved highly controversial, as it brings loan schemes used since 1999 into scope, and many of those potentially affected have argued that they had no expectation that when they entered a scheme that they might have to pay tax in the future.

In light of this, in September 2019 the Government announced Sir Amyas Morse would lead an independent review to “consider whether the policy is an appropriate way of dealing with disguised remuneration loan schemes used by individuals who entered directly into these schemes to avoid paying tax.” Following the 2019 Election Sir Amyas’ report was published on 20 December, making a long series of recommendations with major implications for those affected. In turn the Government has accepted all but one of these.

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450 Budget 2016, HC901, March 2016 para 2.16-7. Statutory provision for the Loan Charge was included in the Finance (No.2) Act 2017, with supplementary provisions in the Finance Act 2018.

451 see, for example, PQs152724-157732, 20 June 2018

452 HMRC, Disguised remuneration charge on loans: issue briefing, June 2019

453 HM Treasury, Disguised remuneration: independent loan charge review, 5 November 2019

A Library briefing paper discusses the background to the 2019 Loan Charge, and the implications of Sir Amyas’ review in greater detail.455

The first section of the Sir Amyas’ review discusses the emergence on loan schemes in the early 2000s, and it observes that “it was it was only possible for loan schemes to proliferate due to the creation of a market of potential individual scheme users.”456 Notably one of the drivers to the growth of this new market was the introduction of IR35:

The government introduced legislation in 2000, known as IR35, to counteract the use of Personal Service Companies (PSCs) as a method of ‘disguising employment’. These off-payroll working rules sought to ensure that those using PSCs to disguise their employment status were charged tax on the underlying employment relationship.

The Review heard that this increased uncertainty for workers, with it being said that individual workers often would struggle to know whether they were in scope of the legislation. Individuals therefore looked for ways to retain their level of pay after tax, but without the risk associated with working through a PSC.

One option was to work through an umbrella company – a structure which provides employment to a number of individuals, signing contracts to provide individuals’ labour to third parties. This is and was always possible without entering into a loan scheme, with the vast majority of people employed through umbrella companies not using a scheme. Neither was scheme usage widespread amongst freelancers; of a population of 2 million HMRC estimate that just 2.5% used loan schemes.457

But those who devised loan schemes now had a larger market of potential users, such as those attracted to arrangements which would provide certainty on IR35, or an increase in take home pay compared to alternative options. The Review also saw evidence of loan schemes being sold as part of a package alongside employment through umbrella companies, merging two distinct concepts.458

The review notes that initially the Labour Government had proposed that the onus for determining whether IR35 applied or not should lie with clients, and not with contractors. In its view, the decision to reverse this was a mistake, and that now the reforms to shift this responsibility to engagers in both the public and private sector are to be supported:

The original IR35 proposals would have put the responsibility on primary engagers to assess whether any of their relationships with contractors’ PSCs meant that IR35 applied. This would have placed a much stronger accountability on the primary engagers making the contracting decisions, a principle that this Review supports.

It is therefore unfortunate that, following concerns being raised by business, these responsibilities were instead placed on PSCs, and effectively individual workers, as a result. This meant that

455 The 2019 Loan Charge, Commons Briefing paper CBP8811, 3 September 2020
456 HMT, Independent Loan Charge Review: report on the policy and its implementation, December 2019 para 1.6
457 HM Treasury, Section 95 of the Finance Act 2019: report on time limits and the charge on disguised remuneration loans, March 2019
458 HMT, Independent Loan Charge Review: report on the policy and its implementation, December 2019 paras 1.8-11
contractors were required to assess whether they were within the scope of IR35, and to assess their tax liabilities on this basis. It is important to note that, in an initiative which this Review supports, the government announced in 2018 that it would put responsibility for operating IR35 onto large primary engagers in the private sector from 2020, having already done so in 2017 for public sector engagers.

The Review therefore supports moves to make primary engagers more responsible for the tax status of those they effectively employ.\(^\text{459}\)

### 8.8 Off-payroll review (January 2020)

Following the Conservative Party’s victory in the 2019 General Election, on 7 January 2020 the then Chancellor Sajid Javid confirmed that the next Budget would be presented on 11 March 2020.\(^\text{460}\) The date was confirmed by the current Chancellor, Rishi Sunak, in a letter to the Office for Budget Responsibility on 27 February.\(^\text{461}\)

Although IR35 had not been a major feature of the Election campaign, all of the main parties stated that they would ‘review’ the reforms to IR35. In the Chancellor’s case, Mr Javid gave an interview to the BBC Radio 4’s Money Box programme in which he said, “I value the work of consultants and I want to make sure that the proposed changes are right to take forward.”\(^\text{462}\)

In the meantime, many contractors have continued to raise concerns with Members.\(^\text{463}\) It has been suggested that private sector companies are actively preparing not to engage contractors from this April.\(^\text{464}\) The Association of Independent Professionals and the Self-Employed (IPSE) has raised this concern, following news that Barclays Bank had announced this change in approach.\(^\text{465}\)

The same day as the announcement of Budget day, the Financial Secretary to the Treasury, Jesse Norman, published details of the Government’s review of IR35, which would “determine if any further steps can be taken to ensure the smooth and successful implementation of the reforms, which are due to come into force in April 2020”; details were given in a press notice, part of which is reproduced below:

\(^{459}\) op. cit. paras 1.12-15

\(^{460}\) HMT press notice, Chancellor launches Budget process to usher in ‘decade of renewal’, 7 January 2020

\(^{461}\) HM Treasury, Letter from the Chancellor to the Chair of the OBR, 27 February 2020

\(^{462}\) “Main parties pledge to review IR35 tax reforms after election”, Financial Times, 4 December 2019

\(^{463}\) See, for example, “Businesses at risk from IR35 off-payroll tax reforms” & “Rishi Sunak promises to be fair over IR35 tax changes“, Financial Times, 20 & 24 February 2020; “Freelancers cry ‘foul’ over tax change”, Times, 2 March 2020.

\(^{464}\) See, for example, a briefing by Contractor.UK, a professional adviser for contractors: “Company positions on IR35 private sector reform April 2020”, ret’d March 2020.

\(^{465}\) HR Review, Barclays to no longer use contractors is ‘a taste of the IR35 chaos to come’, October 3, 2019; IPSE press notice, “Inadequate” off-payroll review “leaves freelance sector floundering”, 7 January 2020
The review will focus on the implementation of [the 2018 Budget reforms] which are due to come into force on 6 April 2020.

The government will launch a separate review to explore how it can better support the self-employed. That includes improving access to finance and credit, making the tax system easier to navigate, and examining how better broadband can boost homeworking ...

The review, which will conclude by mid-February, will engage with affected individuals and businesses on their experiences of the implementation of these reforms ...

The off-payroll working rules do not affect the self-employed, as only those working like employees are in scope. As part of the review, the Government will explore whether there are any further steps it could take to support businesses in correctly determining employment status.

In parallel to the review, HMRC will continue its comprehensive programme of education and support activities, proactively helping customers to prepare for the reform to off-payroll working rules in April 2020. This will include one-to-one engagement, webinars and workshops alongside targeted communications and support for customers, and their representatives to help them prepare for implementation on 6 April 2020.466

In its report on the Government’s review, Taxation magazine quoted Qdos chief executive officer Seb Maley as saying, “HMRC itself has said this review is to make sure reform is implemented smoothly, suggesting the government has every intention of rolling out needless changes irrespective of any findings.”467

In its response the CIOT suggested that as the Government had decided to proceed as planned, “the key thing now is for the review to be completed as soon as possible, for appropriate easements to be made wherever possible and for the final legislation and guidance to be issued swiftly.”468 By contrast the Association of Tax Technicians reiterated its case for delaying implementation: “despite today’s announcement, we reiterate our call for the introduction of these rules to the private sector to be delayed until 2021 … We note that the Government’s review is intended to conclude by mid-February, which we believe not only to be overly optimistic, but also only leaves less than two months for its findings to be put into effect.”469

Over this period HMRC published draft secondary legislation, that would underpin two aspects of the new regime: HMRC’s powers to recover unpaid tax from other parties in the supply chain; and, requirements to report off payroll worker indicator on real time information (RTI)

466  HM Treasury press notice, Off-payroll review launched, 7 January 2020. See also, PQ900051-2, 7 January 2019. See also, PQ1065, 15 January 2019
467  “Off-payroll working review launched”, Taxation, 13 January 2020
468  CIOT press notice, Review of the April 2020 changes to off-payroll working will need to move speedily, says CIOT, 7 January 2020
469  ATT press notice, Delay to controversial contractor tax rule needed more than ever, says ATT, 7 January 2020
returns.\textsuperscript{470} HMRC published a technical note alongside the draft regulations; this underlined that in the first case, the transfer of liability across the labour supply chain, “HMRC will not exercise this power in the case of genuine business failure of the party ordinarily liable for the Income Tax and NICs.”\textsuperscript{471}

In addition, HMRC issued a press notice to confirm that the new rules would apply only “to payments made for services provided on or after 6 April 2020. Previously, the rules would have applied to any payments made on or after 6 April 2020, regardless of when the services were carried out. It means organisations will only need to determine whether the rules apply for contracts they plan to continue beyond 6 April 2020, supporting businesses as they prepare.”\textsuperscript{472}

Since 2003 the House of Lords Economic Affairs Committee has appointed a Sub-Committee each year to consider the Finance Bill when it is published in draft form. The aim has been to consider selected technical issues arising from the Bill, and whether the draft legislation could be clarified or simplified. As noted, in July 2019 draft provisions for the Finance Bill were published, including provision for the off-payroll reforms – and in February 2020 the Committee launched an inquiry on this part of the draft Bill.\textsuperscript{473} The Committee’s report was published after the 2020 Budget, and is discussed in the next section of this paper.

The outcome of the Treasury’s review was published on 27 February. The Government confirmed a number of changes to smooth the implementation of this reform; notably in the first year of the reform HMRC will take a ‘light touch approach to penalties’.\textsuperscript{474} HMRC has a single page factsheet setting out its approach, reproduced below:

**HMRC’s compliance approach to the 2020 reform of the off-payroll working rules**

HMRC are delivering a comprehensive programme of education and support to help customers prepare for the off-payroll working reforms. HMRC are committed to continuing to take a supportive approach to help customers apply the new rules.

HMRC has already committed to not using information resulting from the changes to the rules to open a new compliance check into Personal Service Companies for tax years prior to 6 April 2020, unless there is reason to suspect fraud or criminal behaviour.


\textsuperscript{471} HMRC, \textit{Technical note: draft secondary legislation for off-payroll working rules from April 2020}, January 2020 para 10

\textsuperscript{472} HMRC press notice, \textit{HMRC announces change to the off-payroll working rules}, 7 February 2020. HMRC’s online \textit{Employment Status Manual} has been updated to this effect (see from \textit{para ESM10000}).


\textsuperscript{474} HM Treasury press notice, \textit{Government to help businesses with off-payroll working rules}, 27 February 2020
This should provide reassurance to individuals that any change in status as a result of the reform will not lead to HMRC opening a historic enquiry. The commitment is also reflected in the recently updated Employment Status Manual published on 7 February 2020.

HMRC will ensure that customers trying to comply with the off-payroll working rules are not disadvantaged by those who are not. HMRC will focus on and address the most significant risks around non-compliance. HMRC will always follow up on suspected non-compliance if there is a sign of potential criminal activity.

HMRC will raise awareness of the risks of using avoidance schemes and arrangements with individuals, end-clients, employment agencies and intermediaries. A self-help guide has been published for contractors and agency workers on how to avoid entering into noncompliant arrangements.

2020-21 tax year

To deliver this supportive approach in 2020-21 specifically, HMRC will:

- Take a light touch approach to penalties. Customers will not have to pay penalties for inaccuracies relating to the off-payroll working rules in the first 12 months unless there is evidence of deliberate non-compliance.
- Continue to operate a dedicated project team to deliver education on the off-payroll working rules and support customers applying them through:
  - one-to-one education discussions with the largest businesses and agencies,
  - webinars designed to provide all affected businesses with further support,
  - working with specific sectors to identify any particular areas of difficulty and then further target and focus support,
  - checking that the education and support is effective: ensuring that the off-payroll working rules are understood and that customers are taking necessary steps to implement them. Where errors are identified HMRC will help customers to correct them, to pay the tax and National Insurance Contributions that are due and to ensure status determinations are correct going forwards.

The Treasury also published a report on its review that gives more details of its process and findings. A few points from this document are worth highlighting.

First, as part of the review the Government sought feedback from public sector organisations on the impact of the 2017 reforms …

Public sector bodies reflected that there were teething issues with the initial implementation of the reform, concerning the amount of time available to prepare, the usability of the CEST tool, and the quality of the guidance provided. Overall, however, public sector bodies reported that the contractor ‘flight risk’ that some

475 HMRC, *HMRC’s compliance approach to the 2020 reform of the off-payroll working rules*, February 2020
had feared did not materialise following the 2017 reform; though they noted that ongoing disparity in the way that the off-payroll working rules operate in the public and private sector could lead to a loss of skills in the future.

Public sector bodies reported that they continued to engage people with specialist skills and had adapted their business models to comply with the reform. In addition, some public sector bodies reported improved management processes as a result of revisiting contractual arrangements.

... and undertook internal analysis on this issue:

Analysis of the tax receipts following the public sector reform confirmed the Government’s view that compliance with the rules is improving. The reform is estimated to have increased overall Exchequer revenues by £250 million in the first 12 months, achieving more than the level estimated at Spring Budget 2017.476

Second, the review looked at concerns that had been raised about the implementation of the new rules – and in particular, whether there was evidence that compliance concerns were encouraging private sector companies not to engage contractors:

Contractor representatives reported concerns that clients are taking a blanket approach, categorising all engagements as employment, regardless of the facts. The Government has been clear that determinations need to be made on a case-by-case basis. During the review, many businesses and public sector organisations described processes they had put in place to ensure determinations were correct and based on the actual working practices of the individual.

The draft legislation states that the client must take ‘reasonable care’ when determining the worker’s employment status, and will be liable for the tax due if they fail to do so. Businesses requested further guidance on the behaviours indicative of ‘reasonable care’.

The Government is aware that some organisations are considering whether PSCs are the best way to engage contractors who are working like employees. Businesses reported that where individuals had been moved onto payroll, this was a result of a review of the structure of their workforce. However, the Government have not seen any evidence that this indicates an overall change in demand for the services and skills that contractors offer, but will continue to monitor impacts on the labour market.477

As part of the process of reviewing their engagements, companies have been using HMRC’s CEST tool, and the review found that since the enhanced version was launched in November 2019, it had been used “over 230,000 times and user feedback has been largely positive.”478

As noted above, while the review was ongoing HMRC had announced it had updated its Employment Status Manual which detailed (draft) guidance on the new rules – and this includes a section on what constitutes “reasonable care” in these circumstances (see para ESM10014). In light of concerns regarding the status disagreement

476 HM Treasury, Review of changes to the off-payroll working rules: report and conclusions, February 2020 para 2.17, paras 2.19-20
477 op.cit. para 2.13-5
478 op.cit. para 2.17
process, the Manual underlines the point that if, after this process has been completed a contractor still thinks the client’s determination is wrong and they have been taxed incorrectly as a result, the existing Self-Assessment and National Insurance processes can be followed (see para ESM10015). Further to this, the review stated HMRC would publish products to support contractors, including a ‘bespoke webinar’, and guidance on the risks of using avoidance arrangements, “in order to address high levels of misinformation in the market.”

Third, the review notes that in the light of concerns raised, two changes will be made to the legislation – regarding information to be provided by clients, and the position of clients based overseas:

Stakeholders, particularly agencies, told the Government that it would provide clarity for the contractual chain to know when the client organisation is small, and therefore whether they should expect to receive a status determination statement. The Government will bring forward legislation in Finance Bill 2020 to place a legal obligation on clients to respond to a request for information about their size from an agency or a worker ...

During the review concerns were raised about how the rules will apply where the client is overseas. The Government has listened to those concerns and will amend the legislation to exclude wholly overseas organisations with no UK presence from having to consider the off-payroll working rules. This means the existing rules for engagements outside the public sector will continue to apply to engagements where the client is wholly overseas, and the individual’s limited company will continue to determine the status of the individual.

Finally, the Government stated it would “monitor and evaluate the operation of the rules”, and as part of this, HMRC would “commission external research into the impacts of the reform six months after implementation, including on how status determinations are being made.”

The ATT welcomed the review but stressed the importance of HMRC continuing to engage stakeholders “after the new rules in the private sector begin in April, to ensure problems are identified early on and addressed promptly.” The Association also argued that any research on the impact of the reform “needs to be wide ranging and involve not just clients (the businesses which requires workers’ services) but also agencies and workers.” There has also been some analysis on the impact of these changes in the technical press.

Just prior to this announcement the Financial Secretary gave a written statement to announce that the Finance Bill would be published on 19 March; the Minister also confirmed that the Government “remains

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479 HM Treasury, Review of changes to the off-payroll working rules: report and conclusions, February 2020 para 4.13. For details see, HMRC, Tax avoidance schemes aimed at contractors and agency workers, 27 February 2020
480 op.cit. para 4.9-10, para 4.15
481 op.cit. para 5.3
482 ATT press notice, HMRC must keep up off-payroll support, 27 February 2020
483 For example, “Ringing the changes”, Taxation, 27 February 2020; “Correct decision?”, Taxation, 5 March 2020.
committed to legislating those measures published in July 2019, subject to confirmation at Budget 2020." 484

The potential impact of this reform continued to be raised in PQs,485 and prior to the Budget the Government reconfirmed its estimates for the Exchequer impact of this measure:

**Asked by Mr David Davis:** To ask the Chancellor of the Exchequer, how much revenue has accrued to the public purse from IR35 in each year since it was implemented.

**Answered by: Jesse Norman:** The off-payroll working rules (IR35) have been in place for nearly 20 years. They are designed to ensure that individuals working like employees but through their own company pay broadly the same tax and National Insurance contributions (NICs) as other employees who are directly employed.

HMRC do not have an annual breakdown of revenue received from the application of the off-payroll working rules.

The Government estimates that only one in ten personal services companies (PSCs) who should be operating the rules are doing so. This non-compliance is projected to increase from £700 million per year in 2017/18 to £1.3 billion per year in 2023/24.

HMRC have measured the impact of reforming the off-payroll rules in the public sector and estimate that the reform has already raised an additional £550 million in income tax and NICs in the first 12 months since it was introduced.486

Following the Budget, the Financial Secretary was asked about the impact that the proposed reforms had *already* had on the labour market, and as part of his answer noted the following:

> The Government is aware that some organisations are considering whether PSCs are the best way to engage contractors who are working like employees. Businesses reported that where individuals had been moved onto payroll, this was a result of a review of the structure of their workforce.

> However, the Government has not seen any evidence that this indicates an overall change in demand for the services and skills that contractors offer, but will continue to monitor impacts on the labour market. For contractors who would prefer to continue to use a PSC, many organisations will still choose to engage contractors in this way, where this suits their business model.487

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**8.9 Budget 2020 & Finance Bill 2019-21**

**Announcement of a one-year delay to April 2021**

The Chancellor Rishi Sunak presented the Conservative Government’s sixth Budget on 11 March. The Chancellor did not mention IR35 in his Budget speech,488 although the Budget report reiterated the Government’s view that, “it is right to address the fundamental

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485 for example, PQ19757, 3 March 2020
486 PQ19756, 3 March 2020
487 PQ37377, 27 April 2020
488 HC Deb 11 March 2020 cc278-293
unfairness of the non-compliance with the existing rules, and the reform will therefore be legislated in Finance Bill 2020 and implemented on 6 April 2020, as previously announced.\textsuperscript{489}

HMRC did not publish a revised impact assessment, although the Budget presented updated figures for the projected Exchequer impact of the reform for the period 2019/20 to 2024/25, which put the total yield at £4.12 billion over these six years.\textsuperscript{490} Subsequently in answer to PQs on the impact of reform, Ministers referred to HMRC’s original \textit{impact note} published in July 2019, which concluded that 170,000 individuals would be affected.\textsuperscript{491}

In its \textit{Economic & Fiscal Outlook} the Office for Budget Responsibility (OBR) noted that it had revised its estimates of the Exchequer impact of both the public and private sector reforms to IR35:

\textbf{Off-payroll working (also known as ‘IR35’):} this relates to two measures that target off-payroll workers (in the public and private sectors respectively) who work through an intermediary, such as a personal services company (PSC), which enables them to pay less tax and NICs.

The measures move the burden of responsibility for determining whether existing rules apply to the engager rather than the intermediary. The public sector element came into force in April 2017, while the private sector element begins in April 2020. Administrative data on the public sector measure has led us to revise up the yield. The original costing underestimated the growth in the number of PSCs, so a larger-than-expected tax base has been affected.

HMRC analysis also suggests a lower offsetting impact from dividend taxation than initially assumed. Tax records point to a higher-than-expected proclivity to retain profits within companies. One of the reasons for this appears to be owners channelling their entrepreneurial spirit by ceasing trading in order to benefit from entrepreneurs’ relief on capital gains. These changes raise the expected yield of the measures by £250 million by 2024-25.

We asked the Treasury about the Chancellor’s recent statement that he had “spent time with HMRC to ensure they are not going to be at all heavy handed for the first year” of the private sector measure and whether this posed a risk to our forecast. The Treasury confirmed that this reflected existing plans to spend the first year focusing on “education and support”, so did not constitute a change in how it will be implemented.\textsuperscript{492}

As is normal practice, at the time of Budget the Government published the series of Ways and Means Resolutions,\textsuperscript{493} which the House must approve before the introduction of the Finance Bill. Broadly speaking these resolutions allow for provisions to be included in the Bill that will

\textsuperscript{489} Budget 2020, HC 121, March 2020 para 2.178
\textsuperscript{490} HM Treasury, \textit{Budget 2020: Table 2.2: Measures announced at Budget 2018 or earlier that will take effect from March 2020}, March 2020 (item f)
\textsuperscript{491} PQ47213 & PQ47214, 20 May 2020
\textsuperscript{492} OBR, \textit{Economic & Fiscal Outlook, CP 230}, March 2020 pp197-8. For the Chancellor’s earlier comments cited here see, “Rishi Sunak promises to be fair over IR35 tax changes”, \textit{Financial Times}, 24 February 2020
\textsuperscript{493} For details see, HMRC, \textit{Notes on Finance Bill 2020 resolutions}, 11 March 2020. Details on the Bill are collated on the Parliament site.
impose a new tax, renew an annual tax, or to increase or widen the burden of an existing tax. They are formally moved at the end of the debates on the Budget, and usually there is a vote on a number of these reflecting the major or most controversial aspects of the Budget.494

Following the Budget, the Budget debates concluded on 17 March.

In wrapping up the debate Treasury Minister Steve Barclay acknowledged the concerns raised by many about the impact of coronavirus (Covid-19), noted that the Budget had set out a series of measures to support public services, individuals and businesses, and confirmed that the Chancellor would make an announcement after the end of the debate “on the further measures required to provide a comprehensive, co-ordinated and coherent response to the serious and evolving situation that we face.” The Minister went on to announce that the Government had taken the decision to defer the implementation of the reform to the off-payroll working rules for one year, to April 2021:

As my right hon. Friend has said, we will do whatever it takes to give the British people the tools to get through this challenge.

I can also announce that the Government are postponing the reforms to the off-payroll working rules IR35 from April 2020 to 6 April 2021. The Government will therefore not move the original resolution tonight, but will shortly table an additional resolution confirming that we will reintroduce the off-payroll working rules provisions by amending the Bill, with a commencement date of the 6 April 2021.

This is a deferral in response to the ongoing spread of covid-19 to help businesses and individuals. This is a deferral, not a cancellation, and the Government remain committed to reintroducing this policy to ensure that people who are working like employees, but through their own limited company, pay broadly the same tax as those employed directly.495

In a short press notice confirming the one-year delay, the Treasury noted that “the new introduction date will be legislated in the upcoming Finance Bill.”496 Subsequently HMRC flagged the 12 month delay in its Agent Update publication for tax agents and advisers; as part of this it noted, “due to this delay HMRC will be pausing the customer support and education programme that HMRC has been delivering to help customers get ready”:

HMRC will resume education and support activities at the appropriate time ahead of the reform in April 2021. HMRC developed a wide range of guidance and support to help customers prepare for the changes, which are now delayed. These products will be updated shortly and remain available to access to help you prepare for the changes due in April 2021.497

494 Further details on this procedure are given in, The Budget and the annual Finance Bill, Commons Briefing Paper CBP813, 4 March 2021.
496 HMT press notice, Off-payroll working rules reforms postponed until 2021, 18 March 2020
497 HMRC, Agent Update Issue 77, 16 April 2020 p3
Subsequently the OBR estimated that the cost of the one-year delay would be £1.3bn in 2020/21.\(^{498}\)

The Chartered Institute of Taxation welcomed the statement, although it suggested that the Government should reconsider deferring a number of other provisions to take effect from April 2020:

John Cullinane, CIOT Tax Policy Director, said: “We welcome the announcement last night that the reforms to the off-payroll working rules will be delayed from 6 April 2020 to 6 April 2021. We are currently in extraordinary times and many individuals, businesses and employers are already facing significant challenges simply being able to work or to pay the people they employ. These new rules had the potential to significantly impact the labour market, and their deferral is welcome.” …

“There are a number of other measures due to commence in April 2020 which, when considered in the light of our current situation, should really be delayed.

“For example, the Finance Bill is expected to contain measures limiting the availability of Private Residence Relief, including reducing the final period exemption from eighteen to nine months.\(^{499}\) The property market is likely to slow down significantly in the coming months and properties may take much longer to sell than expected, leaving some vendors with an unexpected tax bill. It would be sensible to defer this measure until 2021.

“Also, the new 30 day Capital Gains Tax reporting and payment obligations go live on 6 April.\(^{500}\) As this measure requires an entirely new reporting system, which is not expected to be fully operational by 6 April and has inadequate provision for the digitally challenged or excluded, it would be sensible to defer this until 2021 as well. Given the slower property market it would be unlikely to bring in the expected revenue this year in any case.

“We would encourage the government to look critically at the Finance Bill, and those measures in previous Finance Acts which take effect next month, and defer those which are not absolutely vital. It will also ensure that any remaining measures stand a fighting chance of receiving proper scrutiny.”\(^ {501}\)

As with previous developments in this area, the implications for businesses has also been discussed in the professional press.\(^ {502}\)

**Covid-19 and the prospect of future tax reforms**

As part of its package of measures to support individuals and businesses through Covid-19, the Government has launched two important schemes: the **Coronavirus Job Retention Scheme (CJRS)**, which has

\(^{498}\) OBR, *Coronavirus policy monitoring database*, 14 July 2020; NAO, *Overview of the UK government’s response to the COVID-19 pandemic*, HC 366, 21 May 2020 p28 (Figure 6).

\(^{499}\) For details see, HMRC, *Changes to ancillary reliefs in Capital Gains Tax Private Residence Relief*, 11 July 2019

\(^{500}\) For details see, HMRC, *Capital Gains Tax payment window for residential property gains*, 6 July 2018

\(^{501}\) CIOT press notice, *Tax Institute welcomes delay of off-payroll working rules, but asks the government to go further*, 18 March 2020

allowed employers to claim 80% of the cost of putting employees on furlough, and the Self Employed Income Support Scheme (SEISS). In the latter case self-employed traders who meet the eligibility criteria have been entitled to claim taxable cash grants worth 80% of their trading profits, up to £2,500 per month, for 3 months. The scheme ran from May to July. A second round of the scheme, with a 70% cap, ran from August to October, and a two-part extension of the Scheme, to cover November 2020 to April 2021 has been introduced.

Individuals working through their own PSC may be in position to furlough themselves and claim support through the CJRS, but, as the Treasury Select Committee has noted, benefits are likely to be “minimal” given that owner-manager directors usually pay themselves a minimum salary and take the majority of their income as dividends. There have been calls for the eligibility criteria for these Schemes to be extended to cover dividend income, but without success. In answer to a PQ on 9 June Treasury Secretary, Jesse Norman, set out the Government’s rationale for this:

The Government has worked with stakeholders and carefully considered the case for providing a new system for those who pay themselves through dividends. However, targeting additional support for those who pay their wages via dividends is much more complex than existing income support schemes. Unlike announced support schemes, which use information HMRC already holds, it would require owner-managers to make a claim and submit information that HMRC could not efficiently or consistently verify to ensure payments were made to eligible companies, for eligible activity.

The Government has heard the suggestion made that HMRC could adopt a ‘pay now, claw back later’ approach. However, such an approach would be highly resource-intensive to ensure appropriate compliance, and there is a high risk that incorrect or fraudulent payments could not be recovered, ultimately at the cost of UK taxpayers.

Notably when the Chancellor first announced the SEISS he argued that the eligibility rules were based on the need for a scheme to be both “deliverable and fair”:

Providing such unprecedented support for self-employed people has been difficult to do in practice. And the self-employed are a diverse population, with some people earning significant profits.

So I’ve taken steps to make this scheme deliverable, and fair:

1. to make sure that the scheme provides targeted support for those most in need, it will be open to anyone with income up to £50,000.

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503 For details see, FAQs: Coronavirus Job Retention Scheme, Commons Briefing paper CPB8880, 8 March 2021.
504 For details see, Coronavirus: Self-Employment Income Support Scheme, Commons Briefing paper CPB8879, 9 March 2021
505 Treasury Committee, Economic impact of coronavirus: Gaps in support, HC 454, 15 June 2020 para 38
2. to make sure only the genuinely self-employed benefit, it will be available to people who make the majority of their income from self-employment

3. and to minimise fraud, only those who are already in self-employment, who have a tax return for 2019, will be able to apply

95% of people who are majority self-employed will benefit from this scheme.

The Chancellor went on to say that in the longer-term the Government would have to look at the tax treatment of the self-employed compared with employees:

The scheme I have announced today is fair. It is targeted at those who need it the most. Crucially, it is deliverable. And it provides an unprecedented level of support for self-employed people … But I must be honest and point out that in devising this scheme – in response to many calls for support – it is now much harder to justify the inconsistent contributions between people of different employment statuses. If we all want to benefit equally from state support, we must all pay in equally in future.507

Although the Chancellor did not give discuss a time frame for any review, several commentators picked up on this part of his statement. For example, Faisal Islam, the BBC’s economics editor, referred to this as “the sting in the tail. The Chancellor said he can no longer justify, after things get back to normal, that self-employed people play less than the employed. But that is for another day.”508

Writing in Taxation at this time editor Andrew Hubbard noted that in the Covid-19 world, there was no agreement as to what the Government’s reforms to IR35 did:

From one perspective the rules are a necessary way of combating PAYE and National Insurance avoidance, from another they are an attack on the freedom of freelancers to operate in the manner which best suits them. A third view is that they are an attack on workers’ rights, because they treat freelancers as employees for tax purposes without giving them employment rights.

Mr Hubbard went on to suggest that it was possible that the crisis presented an opportunity for fundamental reform:

We know the chancellor is looking at ways of equalising the tax, in particular National Insurance, burden between the employed and self-employed – this is one of the quid pro quos for introducing the support schemes. Given the fundamental changes that the crisis is bound to have on the economy and on the operation of labour market, is it too much to hope that we will finally get to grips with this issue properly? We need to find a way to create a system that reflects modern working patterns and achieves a real balance between the rights and obligations of different categories of workers. It is a tall order, but perhaps the current situation will be a game changer.509

507 HM Treasury, Chancellor’s statement on coronavirus (COVID-19), 26 March 2020
509 “This week’s opinion: Law should reflect modern working patterns”, Taxation, 27 May 2020
Following this on 20 July the Office of Tax Simplification published a note reviewing some of its past work, including a ‘stock take’ on its work on PSCs and the taxation of the self-employed. In this part of the report the OTS flagged the Chancellor’s statement, as well as the Treasury Committee’s concerns over the difficulties faced by PSCs to obtain Covid-19 support:

The OTS hopes that this note will be a useful contribution to current thinking, noting

• the Chancellor’s statement in conjunction with the 26 March 2020 announcement of the Covid-19 support package for self-employed people: “It is now much harder to justify the inconsistent contributions between people of different employment statuses. If we all want to benefit equally from state support, we must all pay in equally in future.”

• that the lack of information available to HMRC about the amount and nature of company dividends through the present tax administration arrangements for those who work through personal service companies has meant the government has not been able to find a way of providing them with Covid-19-related support (as noted in the Treasury Select Committee’s report of 15 June 2020).

With regard to PSCs, the report recommended “renewed consideration of enabling a small personal service style business to operate through a UK limited company while being treated as transparent for tax”, as well as further investigation of “a statutory definition of employment for tax purposes”, and of the “long-standing structural differences between the income tax and NICs treatment of self-employed people and employees.”

Consideration of Finance Bill 2019-21

The Finance Bill 2019-21 was published on the same day as the Minister’s statement, but the Bill as originally published did not include provision to implement this reform.

The Bill received a Second Reading on 27 April. Opening the debate the Financial Secretary confirmed the Government’s plans to include provision in the Bill to amend the off-payroll working rules:

Last month, my right hon. Friend the Chief Secretary to the Treasury announced that, in the light of Covid-19, the Government will delay the introduction of reforms to the off-payroll working rules in order to give businesses more time to adapt.

However, he was clear that the Government remain fully committed to introducing these reforms to ensure that people working like employees but through their own limited companies pay broadly the same tax as individuals who are employed directly. That has not changed, and the Government will

510 Office for Tax Simplification, OTS evaluation and stock take note, 20 July 2020
511 OTS, Evaluation update and stock take of OTS work on corporation tax, personal service companies and self-employed people’s taxation, July 2020 Executive Summary, paras 2.40-1
introduce an amendment to the Bill in due course to legislate for a new commencement date of 6 April 2021.

The Government will use the additional time to commission further external research into the long-term effects of the reforms in the public sector, with the intention that that research will be available before the reforms come into effect in the private sector in April 2021.512

The Second Reading debate was shorter than normal and the Bill was agreed without a division, as a result of the Commons use of ‘hybrid proceedings’ introduced as a response to the Covid-19 outbreak. That said a few Members raised this issue.

Sir Graham Brady noted the Minister’s announcement of further research, adding, “I hope that Ministers will also take the opportunity to look at whether more could be done to achieve proper clarity of definition between contractors and employees, and at the ill-defined status of worker, which causes considerable confusion.”513 John Redwood observed that a number of self-employed had “lost contracts and work to overseas companies and competitors simply from [the threat of this reform, and] … I therefore urge the Minister to think again and recognise that we need to reward and encourage those people, not threaten them with a new tax.”514 In his speech Dr Liam Fox said, “I reiterate the points that have already made by some of my colleagues about IR35 … what we must not do in trying to right a wrong is put them in a position where they are disadvantaged, without sick pay in line with other workers in the economy, for example.”515 Finally, Saqib Bhatti said that he was “pleased to see the delay in the implementation of IR35 reforms”, adding, “we do not yet know what the world will look like in 2021 or what the landscape for our flexible workforce will be, so it is sensible that we continue to monitor this area, ensuring that our flexible workforce is not left behind.”516

As noted in the last section of this paper, in February 2020 the House of Lords Economic Affairs Committee, which usually establishes a Sub-Committee each year to consider aspects of the draft Finance Bill, launched an inquiry on the proposed reforms to IR35.517 The Committee’s report was published on the same day as the Finance Bill’s Second Reading, and recommended that the Government should use the 12 month delay to “completely rethink this legislation.”518

The Committee took the view that the IR35 rules were inherently unfair because “contractors within the rules are treated as employees for tax purposes but do not qualify for employment rights, thus creating a class of ‘zero-rights employees’” and reforming their application in the

512 HC Deb 27 April 2020 c128
513 op.cit. c146
514 op.cit. c148
515 op.cit. c150
516 op.cit. c168
517 Economic Affairs Committee press notice, Lords committee investigates the extension of off-payroll working rules, 4 February 2020
518 Finance Bill Sub-Committee press notice, Government must address IR35’s inherent flaws and unfairnesses, committee concludes, 27 April 2020; “Government accused of pushing tax compliance policing on to business”, Financial Times, 27 April 2020
private sector “could eliminate by stealth contractor flexible working, or force contractors to use umbrella companies without adequate legislative protection.” It agreed that the 12 month deferral was “necessary, but business is likely to need considerably longer than a year to recover from the disruption caused by the COVID-19 pandemic”, and went on to argue “a delay gives time for further consideration”:

The Government should commission an independent review of the introduction of the off-payroll rules in the public sector and undertake an analysis of how introducing off-payroll rules to the private sector will affect the labour market. In addition, the delay provides time to tackle the ongoing deficiencies of CEST and the status determination process, and to revisit the Government’s assessment of the costs to business of the proposals, which our evidence shows were significantly underestimated.

The extra time should also be used to consider alternatives to the off-payroll rules that are fairer and less risky, and which do not treat individuals as employees for tax purposes when they do not enjoy the rights of employees. Once completed, the Government should present Parliament with a clear strategy to address the issue of fairness in the tax system and foster a flexible workforce in which contractors play a vital role.519

Subsequently the Tax Faculty ICAEW published a commentary on the reform, agreeing with the Committee’s recommendation for a review of IR35’s “inherent flaws and unfairnesses”:

[The delay to April 2021] provides an opportunity for reflection on the detail of the measure itself and to undertake a comprehensive review, encompassing the taxation of the self-employed.

Given that many private sector organisations have already incurred significant costs and implemented systems changes the Tax Faculty argues that the government has a unique opportunity to consider whether the rules currently being legislated will work as intended, and to act upon the evidence of those businesses.

The Faculty also argues that there are a number of matters that require resolution before the measure should be adopted including:

• contractors being made to pay the cost of employer national insurance contributions;
• HMRC’s strategy for dealing with certain non-compliant entities;
• aligning employment and social security rights; and
• contractors who are deemed employees under OPW rules need the right to receive statutory payments, eg statutory maternity pay.520

However, in its response to the report, which was published on 1 July, the Government stated that any further delay would be counterproductive …

Any additional delay would have significant drawbacks; it would not address the fundamental unfairness of taxing two people

519 House of Lords Finance Bill Sub-Committee, Off-payroll working: treating people fairly, HL Paper 50, 27 April 2020 para 130, paras 143-5
520 ICAEW press notice, Don’t enact IR35 in Finance Bill, urges ICAEW, 5 June 2020
differently for the same work, and it would further prolong the disparity between the private and voluntary sectors and the public sector, where the rules have been in place since 2017. There is a risk that this continuing disparity could begin to cause retention difficulties in the public sector, as contractors may choose to accept only private sector contracts, as well as being unfair to contractors working in the public sector.521

... and that the alternatives to IR35 discussed in the report “would create a group that are exempt from the employment status tests and subject to a separate and advantageous tax regime, which was not considered to be fair to the majority of working individuals, who are subject to the existing boundary between employment and self-employment”:

The report offers a number of alternative approaches aimed at tackling non-compliance with the existing rules. During the extensive consultation process on the reforms, views were welcomed on alternative options for more fundamental reform. These alternative options, including many of those raised in the report, were considered fully as part of the process and the reasons for not pursuing these options were set out following each consultation.522

The Committee’s report had raised concerns as to whether the administrative burden on businesses of the new regime had been adequately assessed. In its response the Government stated HMRC would review their assessment,523 and this was published in the 2021 Budget.524 This is discussed in more detail below.

As noted above, when Treasury Minister Steve Barclay announced the one-year deferral to the House, he noted that the Government would table an additional resolution to this effect. In brief, a Finance Bill would be regarded as exceeding its proper scope if it imposed a tax which was not to be charged until after the close of the current financial year. To avoid this limitation, Ministers will present one or more Procedure Resolutions, if the Bill is going to contain provisions of this type.525

On 19 May the House approved the ways and means resolution that allows the Government to add a new clause and Schedule to this effect.526 On this occasion the Financial Secretary Jesse Norman set out the Government’s position, opposing an amendment to the motion tabled by David Davis, to delay implementation a further two years …

By delaying until 2021, the Government have already ensured that businesses and contractors will not need to make final preparations for this reform until next year. There is therefore no need for further delay. Moreover, such a delay would have very significant drawbacks. It would not address the intrinsic unfairness

521 HMT/HMRC, Government Response to the report from the Economic Affairs Finance Bill Sub-Committee on off-payroll working, 1 July 2020 para 8
522 op.cit. para 44, para 43. See also, “Off-payroll working rule reforms are fair, says the government”, Taxation, 28 July 2020
523 op.cit. paras 34-37
524 For details see, HMRC, Off-payroll working rules from April 2021, 3 March 2021
526 HC Deb 19 May 2020 cc542-554. HMRC has also published an explanatory note on the draft legislation to be tabled to make this change: Finance Bill 2020: Public Bill Committee, 19 May 2020.
... and addressing a number of concerns Members had raised about the impact of this reform:

I want to address a number of further concerns that have been pressed by colleagues ...

The first of these is that organisations will no longer engage with personal service companies as a result of this reform, reducing the number of contracts available in the labour market ... Some organisations have clearly decided to change the balance of their employees and their contractors. That can be for many reasons—for example, where that better suits the evolving business model of that organisation—but many organisations will still choose to engage contractors using personal service companies where that is appropriate to their business.

Nevertheless, the Government remain keen to ensure the long-term flexibility and success of the labour market. We will therefore use the additional time given by this one-year delay to commission further independent and robust research into the long-term effects of the 2017 reform on the public sector. We want that research to be available before the reform comes into effect in other sectors in April 2021, and I can tell the House that the Government will give careful consideration to the results of that further research and thereafter will continue to monitor the effect of the reform on the labour markets of those sectors, including by commissioning independent research six months after this private and voluntary sector reform has taken effect.

Secondly, colleagues have concerns that organisations might take a blanket approach to status determinations, categorising all engagements as employment, regardless of the facts. The Government have been very clear that determinations must be based on an individual’s contractual terms and actual working arrangements. Many businesses and public sector organisations have described processes that they have put in place to ensure that determinations are correct, based on the actual working practices of the individuals concerned.

There is a vigorous contractor lobby, which has also shown itself willing and able to highlight cases where it feels that the rules are not being followed. The reforms themselves include a client-led status disagreement process, where contractors can lodge a complaint if they disagree with how they have been categorised.

Thirdly, HMRC is continuing to help businesses to get their employment status determinations right by ensuring that they have access to a wide programme of education and support ...

Finally, HMRC has committed to a light-touch approach to penalties in the first year of the reform and has stated in terms that the reform will not result in new compliance checks being opened into previous tax years unless there is reason to suppose or suspect fraud or criminal behaviour, and the same is true for penalties for inaccuracies. op.cit. cc543-4
Speaking for the Opposition shadow Minister Dan Carden stated that “the Labour party broadly supports the decision to delay”:

We have raised concerns about the implementation of this reform and have called for a proper and thorough review before the roll-out to the private sector, and, as the Financial Secretary recognised, the additional time now available gives him an opportunity to get to grips with these concerns, but we do need reform.

The Labour party is committed to modernising the law around employment status, including new statutory definitions of employment status, and the Government’s own Taylor review was right to conclude that the nature of the tax system acts as an incentive for practices such as bogus claiming of self-employed status, both by businesses and individuals. It called on the Government to make the taxation of labour more consistent across employment forms while at the same time improving the rights and entitlements of self-employed people.528

In making the case for an extended delay David Davis also referred to the Taylor Review, and the position taken by the Lords Economic Affairs Committee:

The Lords recommended that the Government adopt the Taylor review proposals … as they offer the best long-term alternative solution to the off-payroll rules and provide an opportunity to consider tax, rights and risk together, as they should be. Despite what the Financial Secretary said, however, the Treasury has neither the time nor the capacity for a wholesale review right now. Therefore, the only sensible course of action is to pause these reforms and take the time to properly review the impact they will have on the self-employed.529

Speaking for the SNP Alison Thewliss raised concerns about the anticipated review of the impact of the 2017 reforms:

There is a real lack of proper assessment and understanding of the impact this has already had in the public sector … Further, the House of Lords Committee points out that shifting responsibility on to business for a scheme that is not fit for purpose is the Government and HMRC ducking a degree of responsibility …

A deferral for a year gives the Government and HMRC some time, but they must use it wisely. Although some research has been carried out already, other people have looked at this and the industry understands what they need and what the norm is in their sectors, the outcome is still very unclear. The Government have said that they will use this year, but can the Financial Secretary say when that review will be completed and when it will actually be available for people to see and reflect on?530

Speaking for the Liberal Democrats Sir Edward Davey argued that the Government should review the case for this reform itself:

I am really struck by the Government’s approach, which is … creating zero-rights employment — employees without employment rights. … I had expected a review because the former Chancellor of the Exchequer said so during the last general election campaign … The Minister today is promising a review

528 op.cit. cc545
529 op.cit. c546
530 op.cit. c547
once the legislation is on the statute book. That is not a review—that is trying to make good once the stable door has closed. Any review must take place ahead of any legislation, if it is to be done in good faith.531

In response the Minister underlined the purpose of the further research the Government was committed to …

The hon. Member for Glasgow Central (Alison Thewliss) spoke of a review. She should be perfectly clear that I have at no point discussed a further review. We had a review earlier this year, contrary to what the right hon. Member for Kingston and Surbiton (Sir Edward Davey) said. It was a perfectly good-faith discharge of a commitment made during the general election. It involved a wide range of parties discussing how the reforms could be effectively implemented, and several important changes were made as a result of it. Of course, it followed two processes of consultation, draft legislation and a full pre-legislative history.

We are not talking about a further review. We are talking about two pieces of research. The first, later in the year to come before April 2021, will look at the long-term effects on the public sector … The second piece of research, which I mentioned earlier, will come at the end, after the reform has been introduced. It will be an early take on the effects on the private sector in the first six to 12 months of its introduction.

… and reiterated the Government’s position on any further delay:

I encourage all Members who would like a further delay to reflect on the points that I made about the intrinsic unfairness of taxing two people differently for the same work, the disparity that it would continue between the private and public sectors, and the significant fiscal cost that would be involved in doing so.532

In turn the Government tabled a new clause and Schedule to the Finance Bill, and this was agreed in Public Bill Committee, unamended and without a division, on 18 June.533 Introducing these provisions the Financial Secretary said the following:

The new clause and new schedule are being introduced at this stage via a Government amendment with a new commencement date of 6 April 2021. That follows the announcement of a delay to the introduction of the reform on 17 March 2020, as part of the Government’s covid-19 economic response package. This ensures that businesses and contractors will not have to implement and adjust to the reform until next year. HMRC will continue to provide a comprehensive package of education and support in the run-up to the new implementation date, building on the extensive preparations made in anticipation of the original implementation date.534

Speaking for the Opposition Wes Streeting said, “it is right that the Government have taken the decision to delay the implementation of the roll-out until April 2021”, and went on to argue that the Government should “take a broader approach in order to modernise the law on employment status and to look at how it interrelates with tax status, so that we have a genuinely joined-up approach that brings together the

531 op.cit. cc550-1
532 op.cit. cc553-4, c553
533 Public Bill Committee (Finance Bill), Ninth Sitting, 18 June 2020 cc247-256
534 op.cit. cc248-9
issues of tax and employment law.” Speaking for the SNP Stephen Flynn opposed the principle of reform, arguing that “IR35 is creating a new group of zero-hours employees paying full taxation but without receiving the associated employment rights … It is time to give back, not time to double down on the damage, so I urge the Government to reconsider what they are putting forward.”

There were also contributions from Andrew Jones, emphasizing the need “to balance employment rights and protections between the employed and self-employed, while ensuring that the rules do not have a sclerotic effect on our economy” – and Miriam Cates, who noted that “I am pleased that the changes to IR35 have been delayed for a year to give our economy some chance to stabilise after covid-19, but fairness should be the foundation of our tax system and properly applied, the regulations will help to achieve that aim.”

The House completed its scrutiny of the Finance Bill on 1-2 July, and on the first of these days, debated amendments tabled by Members in relation to IR35 although no further changes to this legislation were agreed.

On this occasion David Davis proposed that private sector reform should be deferred a further two years: “amendment 20 would delay the imposition of the IR35 rules from 2021 until April 2023. It is very unlikely that the economic crisis we are facing will be over by April 2021 and attempting to implement IR35 will cost jobs and do serious economic damage.”

Speaking for the SNP Alison Thewliss concurred: “instead of pressing ahead with the discredited IR35 in the Bill, the Government should take the advice of the House of Lords … they should pause this policy and go back to the drawing board. It seems evident that the UK Government have not learned from their previous experience in the public sector and are ploughing on regardless.”

Speaking for the Opposition on this occasion Pat McFadden said:

On IR35, we have always said that we need an approach that brings together the consideration of tax and employment law and that levels up protections for the self-employed, as well as dealing with the current implications of the tax system, which sometimes boosts bogus self-employment …

Given the huge ongoing labour market difficulties caused by the current crisis, I would like to ask the Minister what consideration the Government have given to the timetable for their proposed changes and, in particular, what their attitude is to the amendments before us tonight calling for a delay in the roll-out of

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535  op.cit. cc249-50  
536  op.cit. cc250-1  
537  op.cit. c254; c255  
538  For full details of the new clauses & amendments tabled, and those these voted on, see, Finance Bill: Report Stage Proceedings [First and Second Days], 2 July 2020.  
539  HC Deb 1 July 2020 cc442-3  
540  op.cit. c444
the IR35 changes to the private sector, so that we can get the balance between tax and employment rights correct.\(^{541}\)

However, in response the Financial Secretary simply noted “the level of non-compliance at the moment with the rules is scheduled to cost the country £1.3 billion in 2023-24 if not addressed … I encourage Members to vote against [this amendment]”\(^{542}\) and in the event the amendment was defeated \textit{317 votes to 254}. Following the passage of the Bill, these provisions now form section 7 and Schedule 1 of the \textit{Finance Act 2020}.

8.10 Recent developments

At the time of the 2020 Budget the Government published a series of tax policy consultations and calls for evidence. On 28 April the Financial Secretary confirmed that, in the light of the significant disruption due to Covid-19, the Government would extend the deadlines for responses for a number of these, and delay the publication of a number of other tax policy documents\(^{543}\). A first tranche of draft provisions to be included in the next Finance Bill, on ‘L-day’ on 21 July.\(^{544}\)

With the continuing economic impact of Covid-19, the Chancellor gave three statements on the economy over the next months: \textit{A Plan for Jobs} on 8 July,\(^{545}\) the \textit{Winter Economic Plan} on 24 September,\(^{546}\) and an \textit{Economic Statement} on 5 November.\(^{547}\)

On 25 November Mr Sunak presented the Government’s \textit{Spending Review}, alongside the OBR’s latest economic and fiscal forecast.\(^{548}\) In the light of these events, the Budget, which had been expected in the Autumn, was deferred to 3 March 2021.\(^{549}\)

During this time the Treasury introduced secondary legislation to amend the law governing PAYE (\textit{SI 2020/1150}). As set out in a letter from the Financial Secretary to the Treasury Committee, the regulations would allow HMRC to recover unpaid tax debts “from the client receiving the worker’s services, or the first agency in a labour supply chain, where the off-payroll working rules apply to an engagement and there is no realistic prospect of recovering the outstanding debt from the deemed employer within a reasonable period.” The Minister also set out a number of changes that had been made as a result of the review of the off-payroll working reform that had been launched in January 2020, and consultation on the draft of these regulations:

\(^{541}\) \textit{op.cit.} c437  
\(^{542}\) \textit{op.cit.} c465  
\(^{543}\) \textit{Written Statement} HCWS211, 28 April 2020  
\(^{544}\) \textit{Written Statement} HCWS400, 21 July 2020  
\(^{545}\) HC Deb 8 July 2020 cc973-8; HM Treasury, \textit{Plan for Jobs}, CP261, July 2020.  
\(^{547}\) HC Deb 5 November 2020 cc502-4; HMT press notice, \textit{Government extends Furlough to March and increases self-employed support}, 5 November 2020  
\(^{549}\) \textit{Written Statement} HCWS679, 17 December 2020
As a result of the review and consultation on the draft regulations a number of changes have been made, including:

- delaying the implementation date to support businesses and individuals affected by the impacts of COVID-19;
- excluding wholly overseas clients from needing to consider whether the offpayroll working rules apply; requiring clients to confirm their size at the request of the worker or agency the client contracts with; limiting the time by which representations about incorrect status determinations can be made;
- ensuring the rules only apply to work carried out from the 6 April 2021;
- reducing the time period in which a recovery notice can be issued by HMRC from 24 months to 12 months;
- including the details of the deemed employees within the recovery notice so that the agency or client receiving the recovery notice can know the worker to whom the debt relates;
- as well as other minor technical changes, including simplifying language where possible.550

On 12 November the Financial Secretary announced the publication of a second tranche of draft provisions for the forthcoming Finance Bill. As part of his statement the Minister confirmed the Bill would contain “a technical change to the off-payroll working rules [to] … ensure the legislation operates as intended from 6 April 2021 for engagements where an intermediary is a company. The change will correct an unintended widening of the definition of an intermediary, which went beyond the intended scope of the policy.”551

Prior to this the Government had introduced regulations (SI 2020/1220) to implement the necessary changes to NICs law covering off-payroll working in line with the changes made to income tax law by Finance Act 2020.

The Lords Economic Affairs Finance Bill Sub-Committee, which had published a critical report of this reform in April 2020, noted that the regulations were flawed, because they replicated the unintentional error that had been made in Finance Act 2020 regarding the definition of an intermediary. The Committee took the view that in doing so the Government had “seriously neglected a basic constitutional principle … it should not make legislation which it knows in advance does not reflect its policy intent. We can find no precedent for this breach of good government.”552

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550 Treasury Select Committee, Letter from the Financial Secretary relating to off-payroll working reform, 10 November 2020
551 Written Statement HCWS572, 12 November 2020. See also, HMRC, Employment Status Manual, para ESM10003 (ret’d 9/2/2021)
By contrast in evidence to the Committee the Financial Secretary argued that “the law is not defective as it presently stands; it merely does not reflect the policy intent that we have for it”:

We wish to amend it, and that is what we have in mind. That is well understood across the stakeholder community already …

It would be a very radical move to withdraw the entire statutory instrument. As I say, this is a very small part of it. It would be very badly received by stakeholders who are already organising themselves accordingly, and that is before you get to the question of all the timing and other parliamentary time issues required to make and lay a new instrument. It would be a completely disproportionate response to the problem we have identified …

The statutory instrument is on the statute book but is not at present in force. It will not come into force until April. That gives us time, of which we will avail ourselves, to change both the primary and implementing regulations … We will have a new statutory instrument that reflects the policy intent in time for the start of the new financial year.553

In a follow-up letter to the Committee the Minister said:

The Government fully recognises the Committee’s concern that laying legislation which then requires amendment before it comes into force is highly unusual … Our goal is simply to address the issue identified while maintaining progress with an important, much needed and widely anticipated piece of legislation … I am clear that the Government has no desire or intention that it should be repeated.554

In its report the Committee concluded that “more broadly, this matter strengthens the view set out in our report on off-payroll working that the Government should consider the rise of self-employment in its wider context, and not just as a question of tax compliance.”555

On 10 February the Minister wrote to the Treasury Committee to give an update on a number of issues in relation to IR35, including confirmation that technical changes to the legislation would be included in the Finance Bill, to be introduced after the 2021 Budget. The Minister noted that Covid-19 had meant a delay into the proposed research on the impact of these reforms:

Independent research on the off-payroll working reforms

I have previously set out the Government’s intention to commission external independent research into the impacts of the reforms. This included:

- Research into the short-term impacts of the 2021 reform for private and voluntary sector organisations; and
- Research into the long-term impacts of the 2017 reform for the public sector, which we said we would aim to publish ahead of April 2021.

553 Economic Affairs Committee, Oral evidence: Draft Finance Bill 2020-21, 7 December 2020 Qs122-3
554 Economic Affairs Committee, Social Security Contributions (Intermediaries) (Miscellaneous Amendments) Regulations 2020, HL Paper 201, 18 December 2020 para 19
555 op.cit. para 26
Research into the short-term impacts of the 2021 reform

Shortly after the 2017 reform in the public sector, HMRC commissioned research on the short-term impacts of the reform. You will be aware that the Government will be carrying out similar research following the reform in April 2021. This will be commissioned this year, and HMRC will work with key external stakeholders in advance to agree the scope and content of the research.

Research into the long-term impacts of the 2017 reform

It has always been the Government’s intention to commission external research as well on the long-term impacts of the 2017 reform for the public sector, with the view to publishing these findings ahead of 6 April 2021. Since then, HMRC have commissioned two pieces of external research to look into these impacts. These are:

- Quantitative and qualitative interviews with public sector organisations
- Qualitative interviews with employment agencies

The external research agency commissioned to do this research are part way through research fieldwork. However, due to the COVID-19 pandemic, HMRC and the external research agency have reluctantly decided to delay the research into public sector organisations because a key group targeted by this research are public sector health organisations. Due to the pressures of the pandemic, the research agency has not been able to contact a sufficient number of public health and other organisations to produce robust findings ahead of April 2021.

At the same time, I have encouraged the agency not to impose additional pressures on the NHS and public sector organisations during this period, so they can focus their resource where they are most needed. Other things being equal, HMRC’s external research agency plans to pick up this research later in the spring, with the view to publishing its full findings later this year.

A summary of the research conducted so far, focused on the education sector, will be published in the spring.

HMRC do not anticipate any challenges with the current research project into employment agencies, and the full findings from this piece of research will also be published in the spring.556

Over this period there have been calls for the Government to delay implementation of this reform beyond April 2021, driven in part by the numbers of company directors choosing to close their businesses,557 but there is no indication Ministers are minded to do this:

Mr Laurence Robertson: To ask the Chancellor of the Exchequer, if he will delay the introduction of the IR35 changes to 1 April 2022 following the effects on business of the covid-19 pandemic.

Jesse Norman: The Government has been clear that the reform of the off-payroll working rules will be introduced on 6 April 2021. Organisations should continue to prepare for the

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556 Treasury Select Committee, Letter to the Chair from the Financial Secretary relating to Off-payroll working, 10 February 2021. See also, PQ154948, 1 March 2021
557 “Tax fears trigger rise in solvent businesses closing”, Financial Times, 31 December 2020
implementation of the reform. Since the reform was delayed in April 2020, Parliament has passed legislation enacting the reform from April 2021.

Many organisations have already undertaken significant preparations to ensure they are ready for the reform and HMRC are committed to supporting organisations and individuals in the run up to, and beyond the reform being implemented. HMRC are providing webinars, workshops and one-to-one calls as well as publishing updated guidance and factsheets in order to enable organisations to prepare.\(^{558}\)

HMRC has updated its guidance for intermediaries and contractors on the changes to apply from April 2021,\(^{559}\) as well as a set of case studies as to how the new rules will work in practice.\(^{560}\) The topic is also covered in some of HMRC’s online webinars.\(^{561}\) The department has also published an issue briefing on its approach to supporting organisations to comply with the new rules; an extract is reproduced below:

This briefing follows the publication of detailed guidance in our Employment Status Manual and our comprehensive programme of education and support activity to support individuals and organisations affected by the changes to the rules, including:

- one-to-one educational discussions with the largest organisations and agencies
- webinars providing support to all affected organisations
- working with specific sectors to identify any areas of difficulty

In February 2020 HMRC published a statement about our supportive compliance approach to the changes to the off-payroll working rules. This explained that we will take a ‘light touch’ approach to penalties.

Customers will not have to pay penalties for inaccuracies in the first 12 months relating to the off-payroll working rules, regardless of when the inaccuracies are identified, unless there’s evidence of deliberate non-compliance. This commitment has not changed.

We have also committed that we will not use information acquired as a result of the changes to the off-payroll working rules to open a new compliance enquiry into returns for tax years before 2021 to 2022, unless there is reason to suspect fraud or criminal behaviour.

**Our compliance principles**

For organisations affected by changes to the off-payroll working rules (client organisations, agencies and deemed employers) from 6 April 2021 these principles will underpin the way we support

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\(^{558}\) PQ151599, 22 February 2021. See also, PQ138497, 20 January 2021; PQ129045, 17 December 2020


\(^{560}\) HMRC, *Case studies - off-payroll working rules (IR35)*, updated 19 January 2021

\(^{561}\) HMRC, *Help and support for tax agents and advisers*, updated 9 March 2021 (see, *Off-payroll working rules from April 2021*).
you to comply, and how we will intervene where we suspect non-compliance:

- we will support customers who are trying to do the right thing and comply with the rules
- we will help customers meet their responsibilities under the off-payroll working rules
- where customers make a mistake, we will help them correct it
- we will check that mistakes are corrected
- we will identify and correct non-compliance with the off-payroll working rules
- we will challenge deliberately non-compliant customers
- we will challenge tax avoidance schemes that claim to avoid the off-payroll working rules or otherwise reduce the tax payable
- we will use a specialist team to carry out all our off-payroll working compliance activity.

Writing on the implications of the new regime in the *Tax Journal*, Stephen Pevsner & Rebecca Wallis (Proskauer Rose) have argued, “as a practical matter [the new rules] are likely to simply result in a game of contractual pass the parcel in relation to the new tax payment, risk and administration obligations away from the private sector clients and onto the contractors except where the contractors have very specialist skills required for specific projects.” In the latter case the authors suggest that contractors are likely to have “reasonable bargaining power”, and that clients are “likely to have to take on the full burden of the new IR35 rules.” In other cases they suggest clients will want to “avoid the new rules altogether”:

Where the 2017 changes to public sector arrangements led to blanket deemed employee determinations because it was considered the safer course of action for public sector clients, anecdotal evidence (backed up by the approach that the authors have seen on recent transactions) shows that the affected private sector client market is likely to want to avoid the new rules altogether …

The new rules do not apply to an end client if the final intermediary in the chain between the client and the contractor is not, effectively, an entity in which the contractor has at least a 5% interest and that intermediary pays the contractor subject to employment taxes. This is likely to lead to end clients demanding that their main body of contractors either become actual employees of the end client or that they engage through an umbrella company which, in each case, employs them and deals with the employment tax obligations.563

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562 HMRC, *Supporting organisations to comply with changes to the off-payroll working rules (IR35): issue briefing*, 15 February 2021. See also, “HMRC confirms ‘soft landing’ in new IR35 guidance”, *AccountingWeb*, 16 February 2021

563 “IR35 changes imminent: what do they mean?”, *Tax Journal*, 26 February 2021
The Low Incomes Tax Reform Group have published some guidance on the importance for contractors in this position to engage with a compliant umbrella company:

If you are a contractor (or agency worker working through a limited company) and fall under the new rules, post April 2021, the cost savings you (or others in your supply chain) may have been receiving until now may well disappear. This may mean that you may not want to continue running a limited company, especially when you consider the additional administration that comes with a limited company.

Therefore, you may wish to, or be asked to, stop working through your own company. Your options are then:

- to try and get taken on directly by the end client as an employee,
- or to carry on working ‘flexibly’, via agencies for example, but under PAYE. This will usually mean that you will need to work through an umbrella company, as agencies do not usually operate PAYE on workers’ wages themselves.

If you decide to, or are asked to, work through an umbrella company, you should make sure you use a compliant umbrella company.

Please be very wary of the potential problems with some non-compliant umbrella companies we outline on our website. In particular, some highly aggressive umbrella companies set up arrangements where, instead of receiving normal taxable pay, workers receive payment in the form of artificial ‘non-taxable’ investment payments, grants, loans, credits and so on.

You need to be vigilant not to enter into these arrangements, as you could end up paying far more than just the tax back to HMRC, as we explain in our news article Agency workers: being promised the world by an umbrella company? Don’t fall for it.

As noted, the 2021 Budget was presented on 3 March. As part of this the Government confirmed that the forthcoming Finance Bill would include provision to amend the off-payroll working rules, as previously announced, and two further technical changes:

As previously announced on 12 November 2020, a technical change will be legislated for in Finance Bill 2021 to address an unintended widening of the definition of an intermediary in the off-payroll working rules legislation, where it is a company. The original legislation went beyond the intended scope of the policy, and this change restores the policy intent.

An equivalent change will also be made to the relevant National Insurance contributions regulations ahead of 6 April 2021. The government will also introduce a Targeted Anti Avoidance Rule (TAAR) to ensure that the definition of an intermediary cannot be exploited.

The government is making two further minor related technical changes to improve the operation of the rules, in response to feedback from stakeholders, which will both be legislated for in Finance Bill 2021. The government will make changes to the rules

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564 Low Incomes Tax Reform Group press notice, Support if you are affected by the upcoming off-payroll changes, 8 March 2021
regarding provision of information by parties in the labour supply chain.

These changes will make it easier for parties in a contractual chain to share information relating to the off-payroll working rules by allowing an intermediary, as well as a worker, to confirm if the rules need to be considered by the client organisation.

The government will also amend a provision relating to fraudulent information. The change will allow HMRC to take action against any UK-based party in the labour supply chain providing fraudulent information.

This will prevent client organisations or deemed employers from facing liabilities where they have relied on fraudulent information provided by another party in the labour supply chain.

These 2 further technical changes and the TAAR will also be effective from 6 April 2021.565

These changes are not anticipated to have an Exchequer impact.566

The Government also published revised estimates that the reform would raise around £3.8 billion over the period 2020/21 to 2025/26.567

Finally, as noted, HMRC has published an updated and revised impact assessment, which includes an amendment estimate of the administrative burden on businesses and individuals; an extract is reproduced below:568

**Impact on business including civil society organisations**

Due to the scope of the off-payroll working rules and the degree of change required by this reform, the impact on business and civil society organisations is expected to be significant, but varied, with some realising savings through reduced administrative requirements.

**PSCs**

There will be continuing savings for around 240,000 PSCs who will no longer have the requirement for determining status or associated accounting burdens. This figure includes PSCs operated by workers whose engagements will be outside the off-payroll legislation.

PSCs will also have the right to request confirmation of a client organisation’s size, which if exercised, may result in an administrative burden for the PSC.

**Client organisations**

Up to 60,000 client organisations outside the public sector are in scope of the reformed off-payroll working rules.

The majority of large client organisations, and a high proportion of medium-sized client organisations, who engage off-payroll workers do so through agencies. One-off costs for these client

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565 HMRC, *Overview of tax legislation & rates*, March 2021 para 1.9
566 HMRC, *Technical changes to make sure off-payroll working legislation operates as intended*, 3 March 2021
567 HM Treasury, *Budget 2021: Table 2.2: Measures announced at Spending Review 2000 or earlier that will take effect from March 2021 or later*, March 2021 (item e). Annual receipts are estimated to be: £30m (2020/21); £1,020m (2021/22); £590m (2022/23); £650m (2023/24); £725m (2024/25); £805m (2025/26).
568 HMRC, *Off-payroll working rules from April 2021*, 3 March 2021
organisations could include familiarisation with the changes, upskilling staff in making status determinations and determining whether the rules apply to their existing off-payroll engagements.

Continuing costs could include making status determinations for any new off-payroll engagements, maintaining a status disagreement process for off-payroll workers who seek to challenge their status determination and responding to requests to confirm the client organisation’s size.

Client organisations that engage PSCs directly will be additionally responsible for deducting Income Tax and NICs and remitting it directly to HMRC for these engagements through Real Time Information returns.

**Recruitment Agencies**

This measure affects approximately 20,000 agencies who provide workers to medium and large-sized client organisations. They will need to operate payroll for any workers they supply who work through their own company (PSC) and fall within the scope of the rules. One-off costs could include familiarisation with the changes, upskilling staff and implementing processes that allow them to operate payroll on the payments made to PSCs.

Continuing costs for these agencies could include making status determinations for any new off-payroll engagements.

During the House of Lords Economic Affair Finance Bill Sub-Committee’s inquiry into the reform of the off-payroll working rules in 2020, HMRC committed to review its assessment of the administrative burden of the changes on businesses and individuals.

The revised assessment has increased one-off and continuing costs, whilst also increasing the estimated continuing savings of the reform. Estimates of the costs are shown in the tables below:

**Estimated one-off impact on administrative burden (£m)**

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<th>(£m)</th>
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<tbody>
<tr>
<td>Costs</td>
<td>19.7</td>
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<tr>
<td>Savings</td>
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**Continuing average annual impact (£m)**

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<tr>
<td>Costs</td>
<td>8.4</td>
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<tr>
<td>Savings</td>
<td>8.7</td>
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<tr>
<td>Net impact on annual administrative burden</td>
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Further details of HMRC’s review of the administrative were set out in the Financial Secretary’s letter to the Treasury Committee in February, mentioned above:

HMRC has concluded that the original administrative burden assessment did not fully reflect the costs of preparing for and complying with the rules.

As a result of the review, the estimated one-off cost to businesses has increased by approximately 37%, from £14.4m to £19.7m, whilst the annual cost of administering the off-payroll working rules has increased by almost 58% from £5.3m to £8.4m. Conversely, there is also an increase in the ongoing savings to contractors and personal service companies (PSCs) of no longer
having to administer the rules, which has increased by approximately 64% from £5.3m to £8.7m.

HMRC recognises that the Finance Bill Sub-Committee have heard evidence from businesses that have incurred greater costs than this. HMRC acknowledges that there will be a range of costs incurred by different client organisations, depending on their size, workforce and industry. The evidence provided to the Finance Bill Sub-Committee indicates that large multinational enterprises with large workforces have incurred significant costs in preparing for the reform. These costs will have been estimated on a different basis to this assessment and include a significant amount of expenditure on advisory services and employment status review services, which HMRC do not include.

HMRC believes that this is a fair and robust assessment of the administrative burden across the impacted population, which is required in order to comply with the obligations under the reform.\textsuperscript{569}

\textsuperscript{569} Treasury Select Committee, \textit{Letter to the Chair from the Financial Secretary relating to Off-payroll working}, 10 February 2021 (see, \textit{Appendix: Reform of the Off-Payroll Working Rules – Review of Administrative Burden}).
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