JOHNSTON CARMICHAEL

Off-payroll working in the private sector

RESPONSE TO HMRC CONSULTATION DOCUMENT ISSUED 05 MARCH 2019

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I. About Johnston Carmichael

As Scotland's largest independent firm of Chartered Accountants and Business Advisors, Johnston Carmichael LLP currently acts for around 14,000 clients of various sizes covering all major industry sectors.

Many of our clients were impacted by the introduction of the off-payroll working rules which were introduced in the public sector in April 2017, including engaging bodies, limited company contractors and employment intermediaries. An even larger proportion of our client base will be impacted by the introduction of off-payroll working rules in the private sector and we are therefore responding to the consultation in our capacity as advisor to these clients, drawing on our experience from the introduction of the off-payroll working rules in the public sector and our knowledge of the issues and challenges faced by our wider client base in relation to the issue of engaging a flexible workforce.

This response follows our participation in the original consultation published on 18 May 2018.

ii. Response to Consultation Questions

Question 1

- ***Do you agree with taking a simplified approach for bringing noncorporate entities in to scope of the reform? If so, which of the two simplified options would be preferable?***

  On the basis that the Government is committed to excluding the smallest organisations from applying these rules, we do agree that a simplified approach is the preferred option in assessing whether a noncorporate entity is within scope of the rules.

  The second option, whereby both conditions would need to apply before the noncorporate entity is within scope of the reforms, would result in fewer businesses being brought into scope than the first option. We therefore consider this option to be more in line with the Government's stated intentions for smaller businesses.

- ***If not, are there alternative tests for non-corporates that the government should consider?***

  No

- ***Could either of the two simplified approaches bring in to scope entities which should otherwise be excluded from the reform?***

  This is unlikely.

- ***Is it likely to apply consistently to the full range of entities and structures operating in the private sector?***

  On the whole, yes, the simplified options should apply consistently across all business types. However, there may be certain sectors, for example the not-for-profit sector, where there is no trading "turnover" and it will therefore be important to define "turnover" within legislation for clarity.

Question 2

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

  The requirement to provide a status determination would increase transparency for all parties which is an important element for these reforms to be successful. The status determination would be most effective where the client has a statutory obligation to outline the main reasons for the determination. This should also be a positive step in reducing situations where clients are adopting a blanket approach in determining status of large groups of workers.

Question 3

- ***Would a requirement on parties in the labour supply chain to pass on the client's determination (and reasons where provided) until it reaches the fee-payer give the fee-payer sufficient certainty over its tax position and its obligations under the off-payroll reform?***

  It is common for multiple parties to be involved in the labour supply chain, particularly in sectors such as Oil and Gas in the North East of Scotland, and it is imperative for fee-payers that there is a clear statutory framework in place to govern the sharing of the client's status determination across the contractual chain. This will ensure that the fee-payer can properly comply with its own obligations under these reforms and be protected in law where this does not happen.

  In our experience with the public sector off-payroll worker changes that were introduced in April 2017, and in discussions with our clients in relation to the proposed private sector reforms, there is a general lack of clarity amongst fee-payers as to their

legal responsibilities and exposure to financial penalties if mistakes are made. Clear HMRC guidance and legislation is needed to ensure that fee-payers have a better understanding of their role and responsibilities under these reforms.

Question 4

- ***What circumstances may result in a breakdown in the information being cascaded to the fee-payer?***

  There could be various situations which could result in an inadvertent failure to provide the relevant information to the fee-payer. In complicated labour supply chains for example, this could happen where one or more parties in the chain fail to pass the information down the line. Even if they do so, there may be a time lag in the fee-payer receiving this information which could result in incorrect payments being made to the worker.

  However, even with more simplified labour supply chains, inadequate systems, ineffective communication channels between the client and fee-payer and a failure by the end client in making the status determination in line with its statutory obligations could all contribute to the fee-payer not receiving the relevant information, or in sufficient time to satisfy its own obligations when paying the worker.

- ***What circumstances might result in a party in the contractual chain making a payment for the off-payroll worker's services but prevent them from passing on a status determination?***

  This is most likely to happen when either:

  a) the party making the payment is unclear, or not aware of, their responsibilities to pass on the status determination to the next party in the chain. Or

  b) there is a gap in the party's off-payroll worker's processes that cause the failure to pass on the status determination.

  It should be possible for the Government to mitigate the risk of either of these situations arising when the reforms are introduced in 2020 through the introduction of clear guidance on each party's roles and responsibilities and effective communication channels in the lead up to 6 April 2020.

Question 5

- ***What circumstances would benefit from a simplified information flow?***

  As outlined in the consultation document, it is largely lengthy labour supply chains which would benefit from a simplified information flow.

It is questionable, however, whether a simplified process that is effective and robust can be achieved without compromising the position of the parties within the chain or in making this overly complicated. This is particularly relevant where the client may not know, or have an existing business relationship with, the ultimate fee-payer.

Our view is that there may be merit in considering the introducing of a system similar to the subcontractor verification process within the Construction Industry Scheme (CIS) to allow fee-payers to access the status determination of the worker directly via HMRC. Such a scheme may not be without its problems in the context of these reforms, and it would be of utmost importance to avoid the process becoming an administrative burden for fee-payers and clients, but such a system may avoid the issues mentioned above.

- ***Are there commercial reasons why a labour supply chain would have more than two entities between the worker's PSC and the client?***

  This can be more relevant in specific sectors, e.g. in Oil and Gas, or Financial Services, where the end client is often a very large organisation with complex resource needs and multiple and complex labour supply arrangements which, certainly within Oil and Gas, can involve multiple jurisdictions.

  It is commercial necessity in being able to source skilled resource in a tight labour market that creates lengthy labour supply chains, not a desire to avoid tax or even to legally make tax efficiencies.

- ***Does the contact between the feepayer and the client present any issues for those or other parties in the labour supply chain?***

  Potentially yes. This could be commercially damaging for the other parties in the chain, for example if the client and fee-payer colluded to enter into a direct business relationship under a separate arrangement. This may also increase the risk of commercially sensitive information being shared to the detriment of the other parties.

Question 6

- ***How might the client be able to easily identify the fee-payer?***

  In many cases, this would form part of the client's normal due diligence process in understanding its supply chains in accordance with other statutory requirements such as the Modern Slavery Act. Identifying the fee-payer as part of that process may involve checks with other parties in the labour supply chain.

- ***Would that approach impose a significant burden on the client? If so, how might this burden be mitigated?***

The extent to which this imposes an additional burden on the client will depend on what internal processes already exist within the business and the complexity of the labour supply chain. Introducing a process similar to the CIS subcontractor verification process may be a workable solution without imposing excessive administrative burdens on clients and fee-payers.

Question 7

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

  If this requirement is adequately addressed within legislation and HMRC guidance, there should be minimal unintended consequences for PSC's, fee-payers or clients. However, there is potential scope for problems with this arrangement if responsibilities are not further clarified when the reforms are introduced next year. Potential problems could include:

  - Fee-payers incorrectly assuming that the lack of a status determination from the client means that the off-payroll worker rules do not apply. This could be as a result of the end client's failure to issue the determination rather than being out of scope because of the small organisation exemption.
  - PSCs misunderstanding how the small organisation exemption applies and automatically assuming the contract is outside the scope of Chapter 8, Part 2 ITEPA 2003.
  - Some PSCs failing to correctly assess status under Chapter 8, Part 2 ITEPA 2003 (as the Government believes is the case under existing legislation) thus creating a perceived advantage over PSCs providing services to organisations that do not qualify for exemption.

  The success, and fairness, of these reforms is largely dependant on effective tax law and guidance and sufficient HMRC resources to support businesses in applying the rules and in penalising those who seek to secure an unfair competitive advantage by deliberately ignoring their obligations.

  For those clients who are exempt as a small organisation, there should be a statutory requirement introduced to formally communicate this status to fee-payers and workers to reduce some of the risks outlined above.

Question 8

- ***On average, how many parties are in a typical labour supply chain that you use or are a part of?***

  Our extensive client base includes the whole spectrum of parties to a labour supply chain, including end clients, fee-payers/other intermediaries and PSCs. In our experience, most labour supply chains involve four or less parties, i.e. the client, the PSC and up to two intermediaries, one of which will be the fee-payer.

- ***What role do each of the parties in the chain fulfil?***

  This varies as explained above. There are usually defined roles within each supply chain. End client and PSC roles are self-explanatory whereas the role of an intermediary between these two will depend on the service being provided. Some intermediaries provide recruitment services (which can often be subcontracted to other organisations) and others provide administration services and some intermediaries provide both.

- ***In which sectors do you typically operate?***

  Our clients operate in all sectors that typically use PSC contractors, e.g. Construction, Financial Services, Oil and Gas, Transport and Logistics, Technology, Public and Not-for-Profit, etc.

- ***Are there specific types of roles or industries that you would typically require off-payroll workers for? If so, what are they?***

  Our clients' requirements for contingent workers varies significantly. The largest demand for contingent workers is in industries where skilled labour is in short supply, most notably in Oil and Gas, Financial Services and Engineering.

Question 9

- ***The intention of this approach is to encourage agencies at the top of the supply chain to assure the compliance of other parties, further down the chain, through which they provide labour to clients. Does this approach achieve that result?***

  Whilst we are generally supportive of measures which protect the Government's purse in the event of non-compliance, it would be important to protect parties within the contractual chain who had fulfilled all their statutory obligations and had taken 'reasonable care' in fulfilling those duties. It would be inequitable for those parties to be imposed with a (potentially sizeable) liability and financial penalties through the failures of another party in the contractual chain through no fault or within the control of their business.

It is difficult to comment further on how this may work in practice until more definitive guidelines and draft legislation are published around this.

Question 10

- ***Are there any potential unintended consequences or impacts of collecting the tax and NICs liability from the first agency in the chain in this way taking such an approach?***

Please refer to the answer in 9 above.

Question 11

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

This may be a more workable solution and would be more in line with the Government's stated intentions of transferring the ultimate responsibility under these reforms to the client.

However, we would again reiterate the importance of ensuring that mechanisms were in place to protect clients where compliance failures were completely outside of their control and where all reasonable steps had been taken.

Question 12

- ***Are there any potential unintended consequences or impacts of taking such an approach?***

Please refer to the answer in 11 above.

Question 13

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

There is no reason why this would impose a material additional burden on the client because this information would be readily available in any case as it is fundamental to the ultimate status determination. In order to increase transparency and reduce instances of misunderstandings, making this a legislative requirement for clients would arguably be a better option.

Question 14

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

We act for a large number of end clients and also a large number of PSCs and it is clear that this is a difficult problem to address. End clients on one hand need to manage the risks to their business, both financially and reputationally, of getting the status determination wrong, which could be significant for those using a large contingent workforce. PSCs on the other hand, need better protection from clients who disregard the rules in making a status determination to suit their own needs.

It is questionable whether the proposed client-led process would be workable, or beneficial to either client or PSC, in reality:

- Larger clients with high numbers of PSC engagements will not have the resource to facilitate discussions with workers each and every time a determination is made.
- The time commitment for the PSC to have these discussions may also be prohibitive, potentially causing a loss of chargeable hours and income.
- There would be no guarantee that a resolution would be reached which would inevitably end with the original determination remaining in place.

Any potential alternative approach to this perennial issue will arguably only work within a statutory framework, for example a legal right to appeal by the PSC where there are grounds to support the status determination is incorrect. Such provisions will need careful consideration by the Government and potential further input from external stakeholders, however, to ensure that the process does not become an administrative burden for clients and PSCs and to prevent abuse of the appeals system.

Fundamentally, however, any approach adopted to address any disputes will have limited success unless and until the Government addresses the underlying issues and complexities in determining employment status under existing tax law, practice and guidance. As recent cases such as Albatel Limited v HMRC [2019] TC07045 and Atholl House Productions Limited v HMRC [2018] TC02263 and, some of the high profile employment law cases involving Hermes, Uber, Deliveroo, Pimlico Plumbers, etc all demonstrate, the laws in determining employment status either from a tax or legal

perspective are overly complex, contradictory and inconsistently applied. There is therefore an urgent need to update and improve legislation and HMRC guidance in this area which will undoubtedly reduce some of the issues being addressed within this consultation document.

Question 15

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

  Yes. Please refer to answer 14 above.

Question 16

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

  In our experience, clients are already incentivised to take reasonable care when these reforms are implemented, because the risks of getting it wrong are too significant. The risk is not isolated to HMRC issuing assessments following an employer compliance review but, commercially, many clients would want to avoid a potential financial exposure being highlighted during a due diligence exercise in relation to a potential merger or acquisition of the business.

Question 17

- ***How likely is an off-payroll worker to make pension contributions through their fee-payer in this way?***

  The take-up of such an arrangement will depend on how simple this process is in reality. If legislation is overly complex, or the administration involved is cumbersome, fee-payers and PSCs are less likely to make contributions in this way.

- ***How likely is a fee-payer to offer an option to make pension contributions in this way?***
  Please refer to answer 17 above.

- ***What administrative burdens might feepayers face which would reduce the likelihood of them making contributions to the off-payroll worker's pension?***

  This may involve excessive form filling either from the pension scheme perspective or from HMRC. Confusing guidance or ambiguity on the payroll aspects, particularly around the contributions being paid from gross pay or net pay, could also be a barrier to this being offered by fee-payers.

Question 18

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

  1. Although this consultation document refers to Government proposals in relation to employment status reforms and wider reforms within the Good Work Plan, the importance and significance of these matters to the reforms for off-payroll workers is arguably being underplayed by the Government. The current legislation at Chapter 8, Part 2 ITEPA 2003 is flawed in many ways, as demonstrated by the many inconsistent and inconclusive decisions adopted by the Tax Tribunals. It would be helpful if the Government could accelerate its plans on employment status and the Good Work Plan and do this in conjunction with the off-payroll worker reforms, so that there is a clearer and fairer tax system for all concerned.
  2. Concerns remain within the tax profession and in industry that the CEST tool is not fit for purpose in relation to determining employment status within these reforms. If the use of the CEST tool is, as we understand it is, still a fundamental element of the Government's and HMRC's approach to these off-payroll worker reforms, it is critical that this is prioritised by the Government for urgent attention. Failure to do so, including working with external stakeholders, will result in serious flaws in the way in which the Government expects clients and PSCs to work with the new off-payroll worker legislation when it becomes law.

iii. Conclusion

- The measures and proposals set out in the consultation document issued on 5 March 2019 are a step in the right direction in terms of implementing legislation that is workable and sustainable for all involved.

- However, further improvements and consideration is required in certain key areas such as transfer of responsibilities within the labour supply chain, the practicalities in providing status determinations to fee-payers and also dealing with disputes between clients and PSCs.

- Furthermore, the ability of CEST to support compliance in this area, and the reliance on existing legislation, guidance and case law to determine employment status under these reforms remain significant concerns for advisors and businesses alike. These areas must be given top priority by the Government in the months ahead if these reforms are to be successful.

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