Response to HMRC Consultation document issued 18 May 2018

Off-payroll working in the private sector

JOHNSTON CARMICHAEL

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I. ABOUT JOHNSTON CARMICHAEL

As Scotland's largest independent firm of Chartered Accountants and Business Advisers, 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 trusted advisers 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.

II. SUMMARY

Johnston Carmichael is generally supportive of Government initiatives to simplify UK tax law and to create a tax system that is fair to all taxpayers regardless of size of business and the sector in which it operates. We also understand the Government's main objectives in seeking to introduce new rules formoff-payroll workers in the private sector, the key objective being to tackle the perceived non-compliance in relation to the current "IR35" legislation.

That said, however, we do have a number of concerns and comments in relation to the proposals published by HMRC and the Treasury which we outline in this paper for further consideration. These generally fall within the following themes:

Timing - highlighting the need for lessons to be learned from the change in rules in the public sector last year and allowing sufficient time for all parties (including HMRC) to be ready for any significant changes being implemented.

Improving legislation – recognising the need for clear, unambiguous legislation backed up by HMRC guidance that is fit-for-purpose.

Practical implications – being mindful of current employment trends and the practical difficulties faced by those affected by any change in rules, again learning from the challenges experienced by those impacted by the public sector changes last year.

III. SPECIFIC COMMENTS

In view of the technical complexity of the proposed changes and extent of potential options for reform, our response to the consultation paper represents a high-level overview and we have not responded to each question individually. However, we would be very pleased to provide any further commentary or clarification ahead of any proposed changes being implemented, for example as part of a focus group. The points we wish to raise are as follows:

Timing

- The implementation of the off-payroll working rules in the public sector in April 2017 was not done within a reasonable enough timeframe to allow public sector engaging bodies to fully understand the new rules and to properly prepare for the new rules coming into force.
- Equally, there was limited consultation with the Government prior to the rules being introduced and a lack of guidance and clarification from HMRC on some of the practical implications for engagers and their contractors.
- This created significant problems in the first few months of the rules being introduced and, it is fair to say, that some organisations in the public sector are still playing "catch-up" in terms of complying with their new responsibilities. Some of the problems faced by those affected include:

    1. Public sector bodies not having enough time to fully establish their contractor population before the 6 April implementation date, being mindful that many of these bodies are huge, diverse organisations with many sites and departments.
    2. Payroll providers being unable to provide payroll solutions in time that could adequately cope with the nuances of the calculations including the interaction with VAT.
    3. A lack of clarity on some of the technical aspects of applying the rules from day 1, including a CEST tool that was still incomplete, resulting in many public sector bodies "panicking" and applying a blanket approach to all contractors, often erroneously.
    4. Many contractors being confused as to the implications for their limited company, and in particular on the VAT position when they were forced to be paid under deduction of PAYE.
    5. Disagreements between public bodies and intermediaries as to which party had the reporting and withholding obligation, due to a lack of clarity in legislation and guidance.
    6. Disagreements between public bodies and their contractors in relation to decisions made using the CEST tool. This caused some operational issues for many public bodies in terms of contractors opting to work elsewhere.

- Considering the above difficulties, it is our view that a more delayed implementation period would be appropriate should the rules be changed in the private sector, i.e. not before 6 April 2020 at the earliest. This would allow engaging businesses, individual contractors, intermediaries, software suppliers, advisors and HMRC to better prepare for the impact of such changes and to apply the rules in the way in which Government intended. This would allow for the issues in relation to the implementation of the off-payroll working rules in the public sector to be appropriately considered.

- We are also mindful of the fact that these changes are being considered at the same time as case law on the subject of employment status is evolving from an employment law perspective, especially around 'worker' status which is a term not recognised by tax legislation. We believe that it would be in the best interests of all parties that there is greater consistency in the way in which tax law and employment law deals with employment status. Greater clarity would assist both workers and end clients/employers and could help facilitate improved compliance and improve the ability for the application of the legislation to more closely reflect stated Government objectives of creating a fair workplace for all.

Improving legislation

The consultation document makes clear the shortfalls of the existing system in terms of the obligations placed on limited company contractors. Indeed, it is highly probable that in many cases there could be several workers engaged on the same project who could adopt differing interpretations of the "IR35" legislation because of its technical complexity.

Whilst we do not necessarily share Government's view that there is widespread non-compliance of "IR35" in the private sector, we do recognise that the current system is not working and therefore change is required. Some of the problems with the current system that we experience on a regular basis include:

- A complete lack of understanding of the rules. This is particularly the case where the engaging business or contractor has not obtained professional advice.

- Confusing HMRC guidance. The prime example being the interaction of "IR35" with the office holder rules.

- Misconceptions around the validity and inaccuracy of the CEST tool.

- Misconceptions around the validity and relevance of "IR35 friendly" contracts.

- An inconsistent approach by HMRC on the tax technical position.

As such, we recognise that there may be varying degrees of compliance at present, the extent to which may vary between sector and the type of work undertaken.

Based on our detailed understanding of the legislation, the practical difficulties many of our clients experience currently with the existing rules or have experienced through the change in public sector rules and having fully considered the points raised in the consultation paper, we believe the following measures are required to address and improve upon this perennial problem area:

1. The introduction of a more comprehensive, principles-based approach within the legislation including a statutory employment status test.

   There is no doubt an employment status test which is easier to apply will be welcomed across the board. A codified version affording certainty to engagers would circumvent the current requirement for them to apply the inherently contradictory principles of prevailing case law and HMRC guidance. As to what a legislative test would look like, only limited parallels may be drawn from the, predominantly objective, Statutory Residence Test (SRT).

   To establish and implement a detailed test which reflects current case law is clearly a complex task and we would therefore reiterate the merit in delaying the commencement of any eventual proposed reform until at least April 2020. As a minimum, a comprehensive period of testing any formulated test with relevant stakeholders prior to a final consultation would seem prudent. It will be imperative that any statutory measures should be clear, relevant to today's working practices and unambiguous. Many of the perceived problems with the current system centre around arrangements that involve regular work for one engager over a sustained period and so perhaps there is merit in considering a de minimis timeframe and/or earnings threshold within the statutory tests.
2. To capture the flux in this area, any legislative provisions need to be supplemented with clear and robust guidance from HMRC. We do not consider that existing guidance in the Employment Status Manual is currently meeting the needs of engagers or contractors nor does it reflect recent developments in prevailing case law.

   If the rules for off-payroll working in the private sector are changed, it will be essential that HMRC guidance is fit-for-purpose to assist businesses in understanding and applying the rules as intended. We would like to see an increased use of relevant examples as this can

often remove some of the ambiguity and also clear explanations from HMRC in any areas of complexity.

3. We believe there is merit in either removing the CEST tool in its entirety or HMRC reducing its relevance in determining employment status, for example by clarifying that the tool is for indicative purposes only with no statutory authority.

   Whilst the current CEST tool can be indicative of the employment status of a working arrangement, it is not necessarily conclusive. Indeed, a loose interpretation of some questions in the tool could result in a different outcome and, whilst HMRC has indicated that it will abide by the responses made, it is our view that the tool is limited in its usefulness.

   It is questionable whether any such tool would ever be sophisticated and robust enough to be fully relied upon to apply legislative tests. Any software tool is only as good as the information being entered into it and, as is currently the case with CEST, where the answers to questions could be subjective, it may be possible to manipulate the tool to achieve a particular outcome.

   Our experience in the public sector is that too many engagers are using the CEST tool as the only mechanism to determine whether the off-payroll working rules apply. Such an approach is flawed given that the CEST tool cannot be considered completely reliable for the reasons mentioned above. We encourage our engager clients to implement robust processes and controls to determine status, only using the CEST tool as a final check as part of that process. We would like to see such an approach encouraged by HMRC and built in to any new measures that may be introduced to the private sector in due course.

4. One of the main objectives in the Government looking to change the rules for off-payroll working in the private sector is to tackle the perceived non-compliance with current "IR35" legislation. However, based on our experience, which is backed up by official statistics from HMRC, a significant part of the problem with the current regime is that HMRC has not dedicated enough resources to identify and penalise those contractor businesses that are clearly within "IR35" but are not applying the legislation. This has created a situation where many engagers and contractors simply ignore "IR35" as there is no real and visible deterrent to do so.

   If the intention with new off-payrolling working rules in the private sector is to prevent "false self-employments", then HMRC has a significant part to play in ensuring that this does not become "IR35 mark 2". In other words, there needs to be a clear and strict penalty regime for those that deliberately fail to apply the legislation backed up by sufficient levels of compliance activity by HMRC. Otherwise, those engagers and contractors who will always look to avoid the law, will continue to do so and it will be the vast majority i.e. compliant businesses, who will be left with the consequences of any changes in the law.

Practical implications

Many businesses impacted by the public sector rule changes expressed concerns that they did not feel supported by HMRC in preparing for and implementing the new rules from 6 April 2017.

Any changes to the off-payroll working rules in the private sector will undoubtedly impact a far greater volume of businesses across the UK and it is therefore essential that HMRC and the wider Government bring in measures to fully support engagers, intermediaries and individual contractors who are affected to avoid the issues that arose in the public sector last year. Our view is that this should include the following:

1. An information raising campaign across multiple communication methods including webinars, industry meetings, advertising and social media to ensure that all affected parties are fully aware of when this is happening and that they are aware of the steps needed to prepare for the changes.

2. Robust and clear guidance from HMRC well in advance of the legislation coming into force in critical areas such as disputes between engager and contractor, contracts involving multiple contractors (to avoid the 'blanket' treatment evidenced in the public sector) and also arrangements where multiple parties are involved in the contractual chain.

3. Dedicated teams within HMRC to assist engaging businesses in moving contractors onto payroll to ensure that Real Time Information submissions and payments are accurate and that other taxes such as VAT are processed in the correct way.

4. A 'soft landing' penalty regime to avoid those engagers with more complicated arrangements and supply chains being heavily penalised for genuine errors as the new rules bed in.

Whilst the extension of the public sector rules to the private sector would broadly treat all engagements involving Personal Service Companies in a similar manner, it does place a significant administration burden on end clients and extra costs by way of employer NIC charges. Many of our clients operate within the oil and gas industry and concerns have been raised within that industry on the potential impact on the availability of workers and the surety of the supply chain of labour and also the financial impact of such changes. Other sectors such as construction and financial services have similar concerns and we would urge the Government to be mindful of this when considering the introduction of any new legislation. We have become aware of instances where public sector end clients have adopted a blanket approach of deeming all engagements to be treated as being

within the intermediaries legislation. This has meant that several arrangements which are not in substance disguising an employee-employer relationship are being treated as being caught. It will be important to ensure that this practice is discouraged, or better prevented, in the private sector if new rules are adopted. For example, by way of an appeal mechanism in situations where the limited company contractor does not agree with the approach taken by the end client. HMRC should also provide guidance in this area to clarify the rights of the worker in such cases (such as whether HMRC may facilitate a means of self-assessment where the worker files on the basis it disagrees with the engager's decision).

Other points of note

We have considered the alternative proposal for businesses to be required to demonstrate that measures are in place to ensure compliance. However, we do not feel that this would be a practical option for several reasons:

- There would continue to be a difference in the treatment adopted between engagements within the public sector and those within the private sector. This could result in perceived disparities remaining within the labour supply chain in terms of the tax treatment.
- The level of administrative burden on end clients would arguably be no less significant than would be the case under the requirement to extend the public sector rules to the private sector. Indeed, it could be more significant as it would require an additional level of interaction with intermediary organisations.

In relation to additional record keeping, both these options would appear to be burdensome in terms of the administration with end clients. The prospect of end clients inadvertently becoming deemed employers with the consequent PAYE obligations would seem particularly inequitable.

The due diligence guidelines already in place for those engagers who utilise third parties to provide them with labour seem a reasonable basis to encourage businesses to check off-payroll compliance.

IV. CONCLUSIONS

- There is a clear need for reform and legislative change in the area of off-payroll workers, not just in relation to "IR35" arrangements involving Personal Service Companies, but also across the multitude of other arrangements that exist in today's commercial world of work. Current legislation is inadequate and not reflective of today's working patterns and there is too much inconsistency between current tax and employment laws and how this is applied to different arrangements.
- However, it is critical for all relevant parties (including HMRC) that any legislative changes introduced are clear and robust, supported by clear and relevant HMRC guidance and implemented within a timeframe that allows all parties to properly understand and prepare for the changes being introduced. The Government needs to take on board the lessons learned from the public sector roll-out in 2017, to do so otherwise could cause significant cost and operational issues to individual businesses and entire sectors which could be catastrophic for the UK economy.
- We would also suggest that limiting the flexibility of the UK workforce prior to the UK exiting the European Union in Spring 2019 may be disadvantageous in terms of the UK's economic prospects and delaying the implementation of any of the recommended reforms until negotiations have concluded merits further consideration.
- It is also clear that the issues in relation to off-payroll workers under current "IR35" rules are intrinsically linked to the wider employment status conundrum under existing tax and NIC legislation and the issue of 'worker' status for employment law purposes which has been debated in numerous high profile legal cases recently. It is therefore imperative that the Government considers these areas simultaneously with a view to developing consistent laws across all these areas of tax and employment law.

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