

# Off-payroll working rules from April 2020

## **Summary of responses**

June 2019

- Government urged to halt reforms until April 2021
- Strong opposition to client-led disagreement process
- Liability model grossly unfair on compliant parties
- Calls for deemed employees to receive employment rights
- Small company exemption deemed unsuitable
- Calls for flawed CEST tool to be urgently addressed

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# 1. Introduction

## Background

In April 2017 Government implemented new legislation in the public sector which replaced the existing intermediaries legislation, often known as IR35. The law currently in place is commonly referred to as the 'Off-Payroll Working' rules and requires the end-client of the personal service company (PSC) to be responsible for assessing the contractor's employment status.

In instances where the contractor is deemed caught by the new legislation, the 'fee-payer' – in most instances the recruitment agency or other third party – is required to deduct income tax and National Insurance (NI) from the contractor's income via Pay As You Earn (PAYE), and make employer's NI contributions in addition to this.

The Off-Payroll rules were implemented despite strong opposition from contracting stakeholders and with assurances from HMRC that the rules would not be extended into the private sector. Following implementation, HMRC and many within the contracting and public sectors have sharply contrasting views regarding the success of the rules.

In the Autumn Statement in November 2018, the Chancellor announced the intention to extend the Off-Payroll rules into the private sector from April 2020. On 05 March 2019, [HMRC published a consultation](#) that sought views on how to ensure the proposals would suit large and diverse sectors. It invited respondents to consider some new solutions and raise any other relevant concerns that they might have. The consultation closed on 28 May 2019.

## Terminology

**Intermediaries Legislation:** This is Chapter 8 of the Income Tax (Earnings and Pensions) Act (ITEPA), enacted in April 2000 and commonly referred to as 'IR35'.

**Deemed employee:** This is a contractor who uses a limited company, but whose hypothetical contract with their client would be considered one of employment, according to employment status case law.

**Employment status case law:** There is no statutory definition of employment. The rules determining employment status are all contained within historic court decisions. Hence it is case law.

**IR35 status:** Determining an individual's IR35 status means assessing whether they would be considered a deemed employee or not under employment case law.

**IR35 applies:** Where IR35 applies, the individual would be considered a deemed employee under case law. This may also be phrased as; 'inside IR35', 'within IR35', 'caught by IR35' or 'failed IR35'.

**IR35 does not apply:** Where IR35 does not apply, the individual would not be considered a deemed employee. Other terms for this are; 'outside IR35', 'not within IR35', 'not caught by IR35' and 'passed IR35'.

## April 2000: Intermediaries legislation (IR35) – Chapter 8, ITEPA

The intermediaries' legislation is contained within Chapter 8 of the Income Tax (Earnings and Pensions) Act ("ITEPA"), enacted in April 2000. This is commonly referred to as 'IR35'.

The legislation requires that, when entering a work engagement, contractors trading via a PSC assess the IR35 status of the contract. If they consider IR35 to apply, they are required to treat their income as employment income for tax purposes. This means deducting the effective rates of income tax, employee's NI and, contentiously, employer's NI from their earnings.

This means first carrying out a calculation which apportions part of their total contract earnings as the employer's NI at 13.8%. What remains is known as the 'deemed payment' from which income tax and employee's NI are deducted via PAYE.

Due in large part to the employer's NI deduction, a contractor caught within Chapter 8 is subject to an effective tax rate much higher than that of an employee. Had the contractor been a sole trader, and HMRC re-assessed them as an employee, the client would be responsible for picking up the unpaid employer's NI. This is the reason why many firms want an arms-length relationship and only hire contractors operating via PSCs; it protects them from tax risk and employment rights risk too.

**Important to note:** The April 2016 dividend tax changes mean that [a contractor now pays roughly the same amount of tax on their income as an employee does on their salary](#). The vast bulk – roughly 84% – of perceived tax lost to the Treasury is avoided by the hirer. This is why the Off-Payroll rules (Chapter 10) are different.

## April 2017: Off-Payroll legislation (public sector) – Chapter 10, ITEPA

In the public sector, the contractor's end-client is now responsible for assessing the contractor's employment status (or 'IR35 status'). Parties are also required to determine who is the 'fee-payer', which is the party in the supply chain closest to the contractor – typically the recruitment agency or other third party, otherwise the client.

Where the contractor is assessed as a deemed employee, the fee-payer must calculate and deduct tax and employee's NI from the contractor's income via PAYE. The fee-payer is also required to make employer's NI and Apprenticeship Levy contributions *on top* of the contractor's earnings (which is known as the 'deemed direct payment').

If the contractor is wrongly processed as outside IR35, the fee-payer is liable for any unpaid taxes.

## Key differences between Chapter 8 ('IR35') and Chapter 10 ('Off-Payroll')

The key differences are:

1. Off-Payroll shifts liability for paying employer's NI from the contractor to the client
2. Onus of assessing employment status has shifted to the client
3. Liability for taxes (if investigated) has shifted to client or agency.

	<b>Intermediaries Legislation</b>	<b>Off-Payroll legislation</b>
	<b>April 2000 Chapter 8, ITEPA</b>	<b>April 2017 Chapter 10, ITEPA</b>
<b>Sector</b>	Private sector only	Public sector
<b>Tax: Employer's NI</b>	Paid out of the contractor's earnings	Paid <b>on top</b> of the contractor's earnings by the fee-payer
<b>Liability (if investigated and found to be inside IR35, when processing as outside IR35)</b>	Contractor holds the tax liability	Fee-payer (the client or agency) holds the tax liability

## 2. Executive summary: Dave Chaplin, ContractorCalculator CEO

The proposals to introduce the new Off-Payroll tax rules to the private sector are of grave concern to freelancers and firms that hire contingent workers. If the Government proceeds, it would mark the biggest event in IR35's history, and not one for the better.

HMRC considers the Off-Payroll tax rules to have proven successful in the public sector, as evidenced within its consultation document, despite drawing from an IFF Research report which acknowledges many of the issues that we and many others have put forward to HMRC over the past two years.

Many of these issues have been dismissed by HMRC as anecdotal and there is a growing perception that HMRC is more than willing to overlook these concerns if it believes it stands to generate a higher tax yield.

That is why we have conducted this analysis of 29 consultation responses of over 400 pages and relevant material from some of the key stakeholders in the contracting sector, tax and legal industries. This document provides a balanced analysis of the key issues highlighted within the industry, some of which we fear HMRC may not acknowledge within its own summary.

The way forward based on these responses is obvious: Delay, review then rethink.



### Summary of analysis conclusions:

- Government is urged to hold fire on further change until at least April 2021
- Strong opposition to client-led status disagreement process proposals
- Proposals to pass tax liability risk onto compliant parties deemed grossly unfair
- Urgent calls for IR35 to be considered alongside Government's Good Work Plan, allowing 'deemed employees' to receive equal rights
- Small company exemption is impractical and prone to exploitation
- Flawed CEST tool needs to be urgently addressed

## 2.1 Key messages from stakeholders

### *Government's response to September 2018 key themes*

Throughout our analysis, a number of consistent themes emerged. Many of these were also recurring issues that were identified when analysing responses to HMRC's 'Off-Payroll working in the private sector' consultation in September 2018. The table below summarises the issues raised in September 2018, whether Government acted on these, and the May 2019 response to Government's action – or inaction. Issues highlighted in **orange** were raised frequently in May 2019 consultation responses.

September 2018 key themes	Outcome	May 2019 response
Delay reform until at least April 2020	Reform delayed until April 2020	Calls for further delay until at least April 2021
Full review of public sector impact required	Ignored	Re-raised
CEST is not fit-for-purpose	Ignored	Re-raised
IR35 needs to be considered alongside Taylor Review and the Good Work Plan	Ignored	Re-raised
Concerns over HMRC's independent research	Ignored	Re-raised
Proliferation of tax-avoidance schemes	Ignored	Re-raised
Fears over timing of change regarding Brexit	Ignored	Re-raised
Differences between public and private sectors	Ignored	Re-raised
HMRC's stance conflicts with the law	Ignored	Re-raised
Small businesses will need considerable support	Proposed small company exemption	Exemption is impractical and prone to exploitation

## *Emerging key themes in May 2019*

In addition to the numerous concerns that were revisited, stakeholders flagged up a number of further issues with Government's latest proposals. The most prominent of these are summarised below:

1. **Further delays until at least 2021 required:** April 2020 rollout doesn't allow businesses adequate time to prepare. The time permitted by the initial postponement has not been utilised efficiently due to Government delays in producing consultation and draft legislation.
2. **Small company exemption is not suitable:** HMRC's proposed means of identifying small companies is difficult to apply accurately in practice. It also enables ways to circumvent the rules and risks market-damaging side-effects.
3. **Client-led status disagreement process won't work:** Proposals to have clients mediate appeals against their own status decisions are deeply flawed. A process led by an impartial, independent party is absolutely essential.
4. **Compliant parties should not bear tax risk:** Strong opposition to HMRC's unfair proposals that compliant fee-payers and end clients could be held liable for tax where a separate party has failed to comply with its responsibilities.
5. **HMRC's compliance assurance proposals are unrealistic:** Individual parties can't be expected to effectively ensure that all other parties in complex supply chains are compliant with the rules.
6. **Concerns over widespread blanket assessments:** Not exactly a new concern, but warnings of rife non-compliance among public sector hirers forcing contractors into false-employment were more prominent in the May 2019 responses.
7. **Warnings over HMRC's failure to acknowledge new tax:** HMRC's refusal to recognise that a new tax will be generated as a result of fee-payers having to pay employment taxes on top of contractor fees is creating confusion.
8. **HMRC's refusal to acknowledge non-compliance:** There has been widespread evidence of non-compliance with the public sector reform. HMRC needs to acknowledge and address this if the private sector is to avoid the same fate.
9. **Question marks over HMRC's non-compliance claims:** HMRC's estimate that the cost of non-compliance with IR35 will reach £1.3bn by the 2023/24 tax year has been challenged in light of contrasting evidence.
10. **The serious threat to flexible working:** Imposing tax liability risk on clients will deter them from engaging contractors, reducing opportunities and damaging workforce mobility. Many remaining flexible workers will likely be forced into false employment.



## 3. Responses to questions in the consultation document

### *Defining the scope of the reform*

This section asked respondents to consider proposals to identify and exempt the smallest end-clients from applying the off-payroll rules. HMRC proposed using the existing statutory definition of a ‘small company’ under the Companies Act 2006. This proposal came in response to widespread concerns that the compliance requirements of the off-payroll rules would place a disproportionate strain on small businesses.

**Question 1:** *Do you agree with taking a simplified approach for bringing non-corporate entities in to scope of the reform? If so which of the two simplified options would be preferable? If not, are there alternative tests for non-corporates that the government should consider? Could either of the two simplified approaches bring entities into scope, which should otherwise be excluded from the reform? Is it likely to apply consistently to the full range of entities and structures operating in the private sector? Please explain your answer.*

### Consultation response

Though generally in favour of a small company’s exemption, respondents identified a number of issues with HMRC’s proposal. Some warned HMRC against issuing a test based on turnover and balance sheet figures which wouldn’t necessarily be final at the time of application.

Others noted that the criteria are open to exploitation, as Companies Act rules enable subsidiaries of a large group to be classified as small, a loophole which some organisations are reportedly already taking advantage of. One stakeholder argued that HMRC would be further impeding its own efforts of tackling perceived non-compliance by exempting what the taxman estimates to be 95% of UK businesses.

Multiple respondents questioned the proposal when “confusion, error and manipulation” were cited by HMRC as reasons not to proceed with a small company exemption when consulting on reverse VAT charges for construction services.

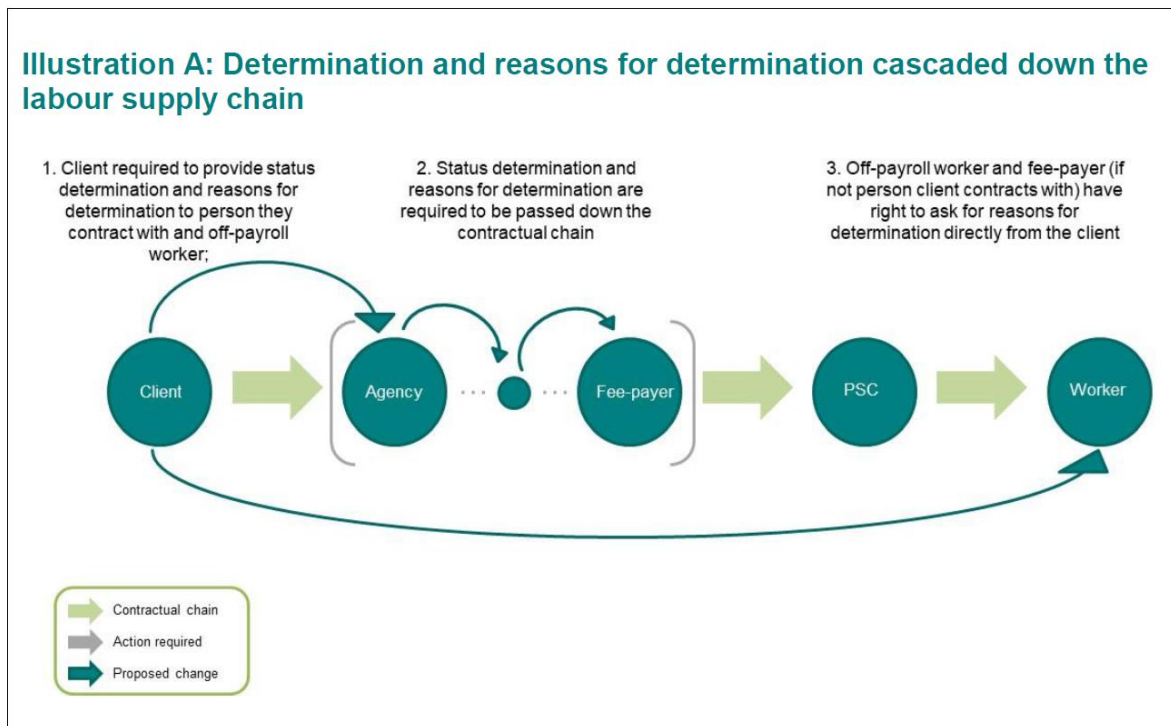
### **Challenges facing Government**

HMRC faces a difficult balancing act implementing an effective and manageable small companies test whilst at the same time ensuring that the off-payroll rules have a realistic chance of recouping their anticipated tax yield.

## 3.1 Information requirements

### Ensuring information is shared appropriately

This section discussed how to ensure that the parties in the labour supply chain have sufficient information to allow them to comply with their obligations under the off- payroll working rules. The following diagram was used to demonstrate the proposed process.



**Question 2** – Would a requirement for clients to provide a status determination directly to workers they engage, as well as the party they contract with, give off-payroll workers sufficient certainty over their tax position and their obligations under the off-payroll reform? Please explain your answer.

**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? Please explain your answer.

**Question 4** - What circumstances might result in a breakdown in the information being cascaded to the fee-payer? What circumstances may result in a party in the contractual chain making a payment for the off-payroll worker's services but prevent them from passing on a status determination?

### Consultation response

Respondents generally agreed that the provision of a status determination to workers would provide little certainty over their tax position. Many argued it would do nothing to reduce disagreements over status or combat blanket assessments. Others noted that direct contact between the client and worker undermines the role of the agency,

and could lead to secondary negotiations regarding fees.

Likewise, the fee-payer could gain little certainty over its tax position because the client's assessment could well be incorrect. In this instance, many noted that the fee-payer would be liable for the shortfall. However, others argued that such a requirement would be essential and it should be made a statutory obligation for supporting reasons to accompany a status determination.

Respondents highlighted a number of potential pitfalls concerning the cascading of information, including lack of understanding among parties, staff turnover, human error, complexities in long supply chains, and IT issues.

### **Challenges facing Government**

Practical difficulties aside, the efficient provision of information down the supply chain would do little to appease workers and fee-payers, who both potentially have a lot to lose from the status determination. Status disputes are inevitable.

- *“88% of respondents to our survey said that a determination from a client would not give them certainty over their status.” – Association of Chartered Certified Accountants (ACCA)*

### **Simplified Information flow**

This section requested feedback on the viability of proposals to simplify information flow by introducing an approach to “short circuit” supply chains by having the fee-payer receive a status determination directly from the client.

**Question 5** – *What circumstances would benefit from a simplified information flow? Are there commercial reasons why a labour supply chain would have more than two entities between the worker's PSC and the client? Does the contact between the fee-payer and the client present any issues for those or other parties in the labour supply chain? Please explain your answer.*

**Question 6** – *How might the client be able to easily identify the fee-payer? Would that approach impose a significant burden on the client? If so, how might this burden be mitigated? Please explain your answer.*

### **Consultation response**

Most respondents considered a “short circuit” approach to information flow an unrealistic prospect, due to the inherent complexity of many supply chains, and the fact that the client often won't have a contractual relationship with the fee-payer.

Some observed that many recruiters will engage other niche agencies into a supply chain in order to access workers with specialist skills for the client. Others noted that certain sectors are prone to having more convoluted supply chains, the entirety of

which clients will often struggle to identify.

It was also agreed that the involvement of a managed service provider (MSP) would often be an indicator of an extended labour chain, as well as a factor which could generate uncertainty as to who the fee-payer is in the scenario. While respondents generally agreed that the client should notify the fee-payer where possible, most acknowledged that this would likely be administratively burdensome in practice.

### **Challenges facing Government**

Ensuring simple and efficient compliant processes across organisations with no prior experience of IR35 will prove a near-impossible task. The fact that HMRC is only now enquiring about the structure of labour supply chains demonstrates how ill-considered the proposals are.

### **Working for a small organisation**

This section sought feedback on proposals for arrangements where a client is exempt from applying the off-payroll rules due to being a small company. HMRC suggested that, where exempt, a client would simply pay the contractor their gross fees while providing no status determination, indicating that the contractor's PSC is responsible for compliance.

**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? Please explain your answer.*

### **Consultation response**

Most respondents were critical of HMRC's suggestion that PSCs should have to interpret an absence of communication by the client, adding that the client should be required to clearly communicate its company size to the supply chain from the offset.

While several suggested that the worker should be considering IR35 regardless, others noted that the lack of clarity could lead contractors to secure IR35 assessments at an expense, only to find that their client had conducted its own assessment.

Several stakeholders acknowledged that a scenario whereby a client has neither conducted a status assessment nor communicated its company size places the fee-payer in a very precarious position, questioning what would then happen with the processing of fees and tax liability.

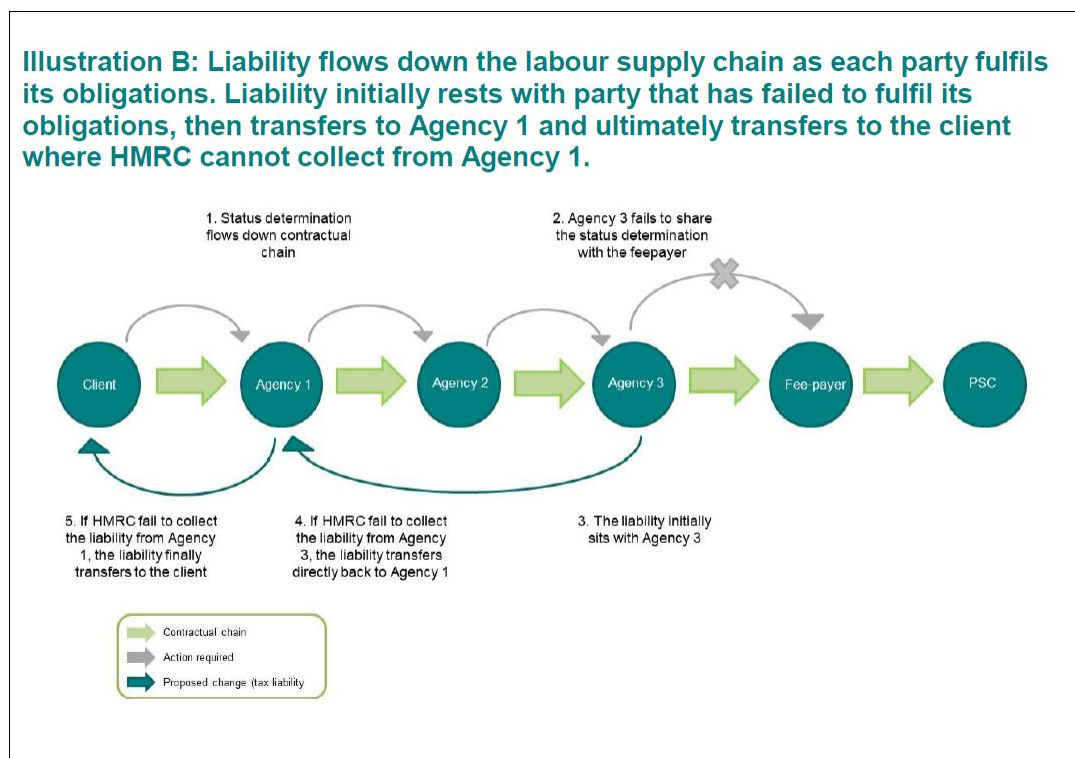
## Challenges facing Government

The proposed small company exemption adds another layer of complexity to the off-payroll rules, which risk placing virtually every party at risk of draconian punishment as a result of miscommunication. HMRC needs to address this issue to offer assurances to affected parties.

- “PSCs should not be expected to apply tax rules based on the silence of the end user client.” – *The Association of Independent Professionals and the Self Employed (IPSE)*

## Addressing non-compliance

In order to ensure that the extended information requirements are effective, HMRC has also proposed to modify the rules that determine when the liability for income tax and NICs should be transferred, illustrated in the diagram below.



**Question 8** – On average, how many parties are in a typical labour supply chain that you use or are a part of? What role do each of the parties in the chain fulfil? In which sectors do you typically operate? Are there specific types of roles or industries that you would typically require off-payroll workers for? If so, what are they?

**Question 9** – We expect that agencies at the top of the supply chain will assure the compliance of other parties, further down the labour supply chain, if they are ultimately liable for the tax loss to HMRC that arises as a result of non-compliance. Does this approach achieve that result?

**Question 10** – *Are there any unintended consequences or impacts of collecting the tax and NICs liability from the first agency in the chain in this way? Please explain your answer.*

### Consultation response

Respondents were heavily critical of HMRC's suggestion that making agencies at the top of the supply chain liable for tax loss would encourage them to ensure compliance amongst others. Stakeholders were unanimous that it would be immoral and completely unjust to assign liability anywhere other than with the party that has failed to comply.

Many argued that it would be impossible for the agency at the top to adequately police the actions of those lower down, without at least drafting significant contractual changes and conducting in-depth auditing and assurance activity. Commentators observed that an agency elsewhere in the supply chain could simply dissolve itself to avoid a financial penalty, resulting in an innocent party suffering an unexpected liability.

Others suggested that agencies are more likely to take evasive action. One such example was the development of contracts explicitly removing this responsibility. Another was that agencies might add more parties to already convoluted supply chains and re-characterise engagements for labour as engagements for services to avoid IR35 altogether.

### Challenges facing Government

HMRC's attempts to rid itself of an onerous pursuit of the culpable party through the supply chain has, quite rightly, received staunch criticism. If HMRC wants to impose unfair compliance responsibilities on so many parties, it will have to devote its own time and resources to weed out the offenders.

- *“The approach achieves nothing other than HMRC's satisfaction that it would have multiple targets for tax collection.” – Association of Recruitment Consultancies (ARC)*

**Question 11** - *Would liability for any unpaid income tax and NICs due falling to the engager (if it could not be recovered from the first agency in the chain), encourage clients to take steps to assure the compliance of other parties in the labour supply chain?*

**Question 12** – *Are there any potential unintended consequences or impacts of taking such an approach? Please explain your answer.*

## Consultation response

While some argued that the client should always be ultimately liable, many respondents were strongly opposed to the idea that a client could be liable for the failings of other parties, having complied with its own obligations. Observing the complexity of many supply chains, several commentators suggested that many clients would be more inclined to seek indemnities from their suppliers than police their supply chain.

The potential damage to flexible working was also a major concern. While some warned that tax liability risk in such instances would further encourage clients to take a risk-averse blanket approach to status assessments, others argued it could deter clients from engaging contractors altogether.

### **Challenges facing Government**

Heaping unfair responsibilities upon parties in complex supply chains will often yield evasive methods rather than compliance. HMRC needs to propose an alternative solution which doesn't incite non-compliance or threaten flexible working.

- *“This would not result in clients taking steps to secure the compliance of others, as it is impossible. The likely result is contracts riddled with tax and NIC indemnities.” – Bauer & Cottrell*

## 3.2 Helping organisations to make the correct status determination and ensuring reasonable care

### *Addressing status determination disagreements between the client and the off-payroll worker and/or fee-payer*

Government recognised concerns raised about the absence of a process to challenge status determinations and raised questions about how to alleviate the issues in this section.

**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?*

**Question 15** – *Would setting up and administering such a process impose significant burdens on clients?*

### Consultation response

Respondents expressed grave concerns over HMRC's proposal to introduce a client-led process for resolving status disagreements, with several arguing that it would represent a barrier to natural justice. It was observed that administering a suitable process would require significant costs and legal expertise which would prove a huge deterrent for clients. One respondent noted: "a client-led process will require expertise that has baffled tax experts for years".

Many commented that clients would have no inclination to overturn a decision based on an appeal, and having a client mediate a challenge to its own status determination would do little to deter 'inside IR35' blanket assessments. This unjust solution would fail to appease contractors, whom some suggested may refuse to provide their services in such circumstances, while others foresaw challenges at the self-assessment stage.

Conversely, one respondent suggested that such an approach may prove more effective than challenging a status assessment with the taxman, given the lack of impartiality demonstrated by HMRC officials.

Stakeholders were unanimous that an appeals process mediated by an impartial, independent party is essential to provide contractors with access to justice, with some arguing it should be written into statute.



### Challenges facing Government

HMRC will struggle to garner any support for this latest unfair attempt to pass the buck onto the supply chain. A fair alternative is a necessity. Implementing a client-led process risks mass ‘false employment’ and damage to labour market productivity due to diminished flexible engagements intensifying skills shortages.

- *“It is highly unlikely that a client would change its mind on a status decision that it has already made, merely because there is a disagreement.” – Recruitment & Employment Confederation (REC)*

**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?*

**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?*

### Consultation response

While some perceived significant administrative and cost burdens, several commentators argued that clients who have taken ‘reasonable care’ should already have reasons for their status determination documented.

Respondents suggested that HMRC could reduce any perceived burden by providing clear guidance on information that needs to be kept, such as a checklist of required evidence that clients are expected to consider in order to have taken reasonable care. Others argued that the ‘reasonable care’ provision needs to be clarified if it is to encourage compliance.

Many argued that requiring clients to provide a status decision with accompanying reasoning would encourage a considered and accurate status assessment. However, several stakeholders agreed that only liability for their decision-making would prove an effective incentive for clients to take reasonable care.

### Challenges facing Government

If clients are to be responsible for conducting status assessments that will affect their own tax liability, the circumstances need to ensure that they are compelled to act compliantly. Stakeholders have made it clear that, in order to achieve this, clients should have to provide evidence justifying their status decision upfront.

- *“It should be a fundamental right for the worker to be provided with not only the status determination but also the reasons behind that decision.”*  
– Larson Howie

## 3.3 Other matters

### Other issues

**Question 18** – *Are there any other issues that you believe the government needs to consider when implementing the reform? Please provide details.*

### Consultation response

Respondents flagged several serious concerns in response to the consultation, demonstrating that, in the eyes of industry experts, HMRC has a lot of work to do before the off-payroll rules become a viable proposition. Many issues raised were recurring concerns that had been voiced in response to HMRC's previous off-payroll consultation, the majority of which had been ignored by the taxman.

### *Delay proposals further until at least April 2021*

Respondents were unanimous in calling for a further delay to allow the private sector adequate time to prepare for the changes. Several commentators observed that many clients lack understanding of the rules and are still unaware of the proposed changes. Others stated that, as a result of the delay, the time permitted by the initial postponement has not been utilised efficiently.

Others noted that firms typically require 12 months to implement new IT systems and associated processes in response to such changes, and that they are only likely to do so once changes have been legislated. Given that legislation isn't finalised until November of each year, the earliest feasible date for private sector implementation is April 2021.

### *Holistic approach aligned with Good Work Plan is required*

HMRC was again heavily criticised for its refusal to consider IR35 holistically alongside proposals put forward in Government's Good Work Plan - specifically, the alignment of employment status definitions for tax and employment rights. The FCSA cited its own survey, which found that 76% of contractors believe employment rights should be attached to an 'inside IR35' determination.

Indeed, several argued that the off-payroll rules oppose the established principles of the Good Work Plan by encouraging exploitation of workers. It was also claimed that the off-payroll rules may soon become redundant if clear, unambiguous rules around status are introduced.

Others warned that a failure to grant employment rights to 'deemed employees' will likely see them take other routes to secure what they believe is due, citing occasions where contractors have successfully used their deemed 'inside IR35' status as the basis for an employment tribunal claim.

- *"The new rules explicitly prevent those classified as employed for tax*

*purposes using that status to benefit from statutory employment rights. This is so contrary to common sense as to be laughable.” – JSA*

- *“This may lead to less people willing to work in the sector as ‘self-employed’ and therefore impact on the flexibility of the workforce. If this flexibility is disrupted significantly, it could impede the necessary supply of medicines and services to patients.” – Pharmaceutical and locum bodies*

### ***HMRC’s refusal to acknowledge new tax liability***

Several respondents raised concerns over HMRC’s sustained denial that the off-payroll rules introduce new tax liabilities. The off-payroll rules require that employment taxes – including employer’s NI at 13.8% - be paid *on top* of the affected contractor’s fee by the fee-payer, whereas the current IR35 legislation deducts this sum from the contractor’s earnings.

Despite this, there has been no admission by HMRC that the proposals will increase the tax take yield from engagers. Many commentators have warned that this misrepresentation of the rules is likely to stoke unwitting non-compliance.

### ***Still no detailed review of public sector impact***

Stakeholders urged Government to commission a detailed impact assessment of the public sector reform before pressing ahead with private sector changes. HMRC has ignored a wealth of evidence demonstrating the damaging impact of the public sector reform, instead relying on spurious conclusions drawn from its own study, launched during the immediate aftermath of the changes.

As noted by many respondents, this study only consulted public sector end clients and was concluded prior to the completion of a full compliance cycle. Consequently, commentators have called for a new report which fully evaluates the effect on engagers, contractors and HMRC, to inform the private sector proposals.

- *“We still have a situation where no proper analysis has been undertaken of how the public sector rules have worked and the true impact, as demonstrated by numerous bodies, has simply been ignored.” – Bauer & Cottrell*

### ***HMRC’s dubious non-compliance estimate***

HMRC’s estimate that the cost of non-compliance with IR35 will reach £1.3bn by the 2023/24 tax year also came under fire. Respondents cited a lack of explanatory evidence in the public domain and contrasting figures from the Office for Budget Responsibility (OBR), which expect the off-payroll rules to yield £661m for the Exchequer in 2023/24. Stakeholders commented that this has contributed to a great deal of uncertainty regarding the true extent of non-compliance.

## ***HMRC's ignorance to widespread non-compliance***

Despite an abundance of evidence, HMRC continues to deny the issue of widespread non-compliance by public sector clients adopting blanket 'inside IR35' status determinations. Respondents have once again stressed this issue, with IPSE commenting: "It seems only HMRC are of the view that blanket assessments have not happened".

Stakeholders have warned that insufficient preparation time and a lack of education mean private sector firms are inclined to follow suit. This threatens to result in recruitment and retention difficulties, headcount reductions, cuts to services, and inflated costs due to renegotiation of rates by contractors.

- *"59% of UK businesses admit to considering taking a blanket approach to managing the legislation, because they don't have the time to assess contractors individually. 45% of businesses have not taken any steps yet to prepare for IR35" – Brookson Legal*

## ***Proliferation of tax avoidance schemes***

Similarly, numerous respondents highlighted the knock-on effects of attempts by public sector clients to deduct employment costs – including employer's NI – from the fees paid to contingent workers. There have been widespread reports of contingent workers moving, often unwittingly, into umbrella loan schemes in a bid to avoid excessive taxation.

Commentators have warned HMRC that a private sector rollout threatens to intensify the issue of avoidance scheme engagement, with some stakeholders making comparisons between the current situation and that which led to the contentious 2019 Loan Charge.

## ***Other prominent issues***

There were numerous other issues raised and recommendations made by respondents, many of which became a recurring theme when examining the consultation responses. Below we have bullet pointed some of the most prominent:

- Concerns over timing of proposals in relation to Brexit-related uncertainty
- Calls for HMRC to align its stance on mutuality of obligation (MOO) with the law
- Fears proposals will intensify skills shortages and damage workforce flexibility
- Calls for HMRC to revisit the removal of the 5% allowance for affected contractors
- Criticism of HMRC's failure to acknowledge the increased cost to businesses
- Concerns over HMRC's failure to learn from public sector experiences (e.g. BBC)

- The requirement of vastly improved compliance support for private sector firms
- Concern that HMRC is using fear and tax risk as a tool to drive business behaviour.

### **Challenges facing Government**

HMRC faces a steep uphill task if it is to garner support for the off-payroll rules. As highlighted by respondents, the consultation phase has been riddled with problems, ranging from unsubstantiated non-compliance estimates and insufficient research into a catastrophic trial run and HMRC's unjustified refusal to consider alternative solutions.

The fact that so many of the issues raised were repeated from the previous off-payroll consultation shows that HMRC has not done enough to act on the very legitimate concerns of stakeholders. It also suggests that the consultation phase was always intended to be no more than a formality.

Consequently, HMRC's blind policy making has resulted in the current proposals being geared towards encouraging rife non-compliance and false employment, which HMRC believes will heighten its tax yield. However, HMRC's refusal to embrace the input of industry stakeholders means it has failed to consider the behavioural impact, which poses a serious threat to its tax take, in addition to UK plc and the flexible labour market.

Should the off-payroll rules go ahead in their current - or a similar - format, the biggest challenge facing the Government will ultimately be its own doing.

- *“To implement further reform now, when the effects of Brexit cannot be fully realised, would be a grave lack of judgment and could have disastrous consequences.” – Qdos Contractor*

## 3.4 What people said about CEST

HMRC's Check Employment Status for Tax (CEST) tool was once again a significant cause for concern amongst stakeholders. Though HMRC has acknowledged that CEST will be improved, many respondents expressed concern that the necessary changes wouldn't be completed well enough in advance of April 2020 to aid private sector preparation, with some arguing that complete re-development of the tool is required.

CIOT argued that private sector firms will require an updated version of CEST by October 2019 at the latest. However, according to the ICAEW, an updated CEST isn't expected to be released until March 2020, which doesn't grant businesses adequate time to review the status of their workers.

Other prominent issues and recommendations concerning CEST included:

- It fails to consider MOO and being in business on your own account (IBOYOA)
- CEST needs independent and transparent testing to ascertain its accuracy
- Status assessment information should be saved
- The private sector needs to be made aware that CEST use is not mandatory
- Delay any change in legislation until there is agreement that CEST is accurate
- CEST does not align with employment status case law.

HMRC's numerous recent IR35 tribunal defeats were also acknowledged, with comparisons made between the rationale adopted by the taxman in these cases and that incorporated into CEST. REC noted: "Having lost those cases, the rationale for CEST must be wrong so how can parties be confident in CEST results?"

### **Challenges facing Government**

Industry experts have made it clear that CEST is too simplistic and narrow in scope to accurately determine employment status on a consistent basis. HMRC simply doesn't have enough time to make the necessary improvements while providing the private sector with adequate time to adopt CEST, unless the proposals are delayed beyond April 2020. Lack of confidence in CEST will inevitably result in a substantial amount of challenges to status assessments, causing disruption within the labour market.

- *"We consider that relying on the CEST tool, as it currently stands, cannot be justified under law, based on a variety of issues that have not been resolved yet." – Ernst & Young (EY)*

- *“CEST remains a work in progress and is not fit-for-purpose.” – Association of Recruitment Consultancies (ARC)*
- *“To reach a status decision that can be relied on based on a maximum of 16 questions – with the likely input of only one party – is impossible.” – Qdos Contractor*



# Annex 1: List of stakeholder responses

ContractorCalculator gathered and analysed consultation responses and related material from the following organisations:

1. [ACCA \(Association of Chartered Certified Accountants\)](#)
2. APSCo (Association of Professional Staffing Companies)
3. [ARC \(Association of Recruitment Consultancies\)](#)
4. [ATT \(Association of Taxation Technicians\)](#)
5. Bauer and Cottrell
6. [Birmingham Law Society](#)
7. Brookson Legal
8. CBI (Confederation of British Industry)
9. [CIOT \(Chartered Institute of Taxation\)](#)
10. [CIPD/CIPP \(Chartered Institute of Personnel and Development/Chartered Institute of Payroll Professionals\)](#)
11. [Crunch](#)
12. [ELA \(Employment Lawyers Association\)](#)
13. EY (Ernst & Young)
14. FCSA (Freelancer & Contractor Services Association)
15. [ICAEW \(Institute of Chartered Accountants in England and Wales\)](#)
16. [ICAS \(Institute of Chartered Accountants of Scotland\)](#)
17. [IPSE \(Association of Independent Professionals and the Self Employed\)](#)
18. [JSA Services](#)
19. [Larson Howie](#)
20. [The Law Society](#)
21. [LSS \(Law Society of Scotland\)](#)
22. [LITRG \(Low Income Tax Reforms Group\)](#)
23. Pinsent Masons
24. [Pharmaceutical and locum bodies](#)
25. PRISM
26. Qdos Contractor
27. REC (Recruitment & Employment Confederation)
28. [Saffery Champness](#)
29. [Simmons and Simmons](#)

For the consultation response from an individual organisation click on the relevant link above.