

## Factsheet

# Consultation on off-payroll working in the private sector



### What are the off-payroll rules and what does HMRC claim is their purpose?

1. The off-payroll working rules – more commonly known as IR35 – claim to ensure that limited company contractors pay the same amount of tax as an employee when they are deemed to be working like an employee.
2. HMRC's pursuit of contractors is mistaken, as the April 2016 increases to dividend tax have meant that **the difference between tax obtained from limited company contracting and employment income is negligible [1]**.
3. Instead, the perceived shortfall is caused by corporations who falsely hire workers as self-employed, **enabling the firms to circumvent their employer's National Insurance (NI) and workers' rights liabilities**.
4. The off-payroll rules seek to reclaim the avoided employer's NI by classing these workers as 'employed for tax purposes only', while **still denying them employment rights**.
5. This type of practice is exploitative and is the subject of a separate Government consultation [2]. However, **HMRC has refused to consider this issue** within the remit of the off-payroll consultation.
6. HMRC claims the cost of non-compliance will reach £1.2bn a year by 2022/23, but **its calculations are based on the incorrect assumption that contractors and employees get paid the same**.
7. Contractors typically charge 30% more than their permanent counterparts, partly to compensate for the absence of employment rights and job security. When this is factored in, **contractors in fact generate more tax than employees**.

### Who is likely to be impacted by reform of the rules?

8. The off-payroll rules will affect all UK self-employed workers and every organisation which sources contingent labour to meet often otherwise unattainable work demands.
9. Non-compliance in the public sector has shown that organisations are willing to circumvent the rules to avoid the 13.8% employer's NI cost of hiring contingent labour [3].
10. In the private sector, **many hirers are expected to force workers into false self-employment to avoid this extra cost, denying these workers employment rights in the process**.

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## Employed or self-employed? Employment status needs to be assessed on a case-by-case basis

Ian would be considered as self-employed for this contract



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Ian is an IT contractor who offers his services through a limited company. He is hired by a Government department to design and develop a specific piece of software. The timescales for completion of the project are at Ian's discretion, and he has the right to use someone else to complete the services. Ian can work off site and is permitted to work for other organisations while working on this contract, providing his work with the client department isn't compromised. Ian has complete autonomy over how work is delivered but is required to provide monthly progress reports to his client.

**This is a real-life example and, although Ian was clearly outside the scope of IR35, HMRC still challenged him at a tax tribunal.** The *Jensal Software Ltd v HMRC* ruling [4] resulted in a comprehensive victory for Ian, raising concerns over HMRC's ability to police the legislation it is seeking to reform.

Jemima would be considered as an employee for this contract.



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The NHS needs locum nurses to help alleviate staff shortages and hires Jemima on a six-month contract. Jemima is required to use hospital equipment while working at the hospital, and although she often has to use her best judgement at work, there are strict health and safety procedures to adhere to. Because of this, **Jemima's client deems her to be 'employed for tax purposes' and unlawfully deducts its employer's NI liability from her earnings.** Jemima loses roughly a third of her earnings as a result of her new tax status, once the withdrawal of expenses has been taken into account. Jemima considers this decrease in earnings as too significant and looks for work opportunities abroad, thereby stretching the resources at this hospital even thinner.

This example is a scenario currently faced by thousands of locum nurses [3]. **The NHS is one of many public authorities failing to comply with the off-payroll rules, subjecting its workers to exploitation as a result.**

### How likely is it that the reform will be extended to the private sector?

11. Very likely. Government wants to implement the same changes by April 2019 and doesn't have time to draft and consult on alternative solutions. HMRC has already ruled out other sensible alternatives that could be considered, and **history tells us that this consultation is little more than a formality.**

### What has HMRC omitted from its published consultation?

12. **HMRC's loss of successive IR35 tribunal cases during the first half of 2018 provides evidence that it struggles to interpret the IR35 rules.** Its defence for the second case, *Jensal Software Ltd v Revenue & Customs* [4], was error-strewn, and suggests that the taxman's stance on IR35 isn't to be trusted. HMRC claims 90% of contractors do not comply, yet has only fully won three of the last ten cases in court.
13. The CEST tool, developed by HMRC to help contractor clients assess employment status accurately, **is not consistent with the employment case law underpinning IR35.** Though HMRC maintains that CEST's results are accurate, it conceded in a Freedom of Information (FOI) response to ContractorCalculator that it has **no evidence to substantiate this claim** [5].
14. **Non-compliance is rife**, whereby public authorities hire contractors through umbrella companies that deduct employer's NI from the contractor's payslips [3].
15. **Patient care with the NHS is in crisis following the reform.** A survey of 450 healthcare locums by ContractorCalculator and the Independent Health Professionals Association (IHPA) suggests roughly a quarter of locums have left the NHS following the reform, with 87% of respondents claiming the reform has drastically impeded patient care [6].

## How has the public sector responded to the reform?

Question	Facts	HMRC claim
Have the off-payroll rules increased HMRC's tax yield?	At this stage, it's <b>impossible to tell</b> . To accurately evaluate the fiscal impact of the off-payroll rules, any increase in income tax via Pay As You Earn (PAYE) and NI needs to be considered alongside the inevitable reduction in Corporation Tax and Dividend Tax payments, the figures for which will be in the tax returns for January 2019. Until these figures are disclosed, whether the off-payroll rules have increased <b>HMRC's tax yield is unknown</b> . The increased cost of hiring contingent labour to public authorities, which one public authority in the HMRC-commissioned IFF report [7] said was between 10% and 15%, also needs to be considered.	The off-payroll rules have resulted in an additional £410m raised in income tax and NICs.
Have public authorities been compliant with the reform and assessed individual contractors on a case-by-case basis?	There is overwhelming evidence demonstrating that public authorities have not been compliant with the rules, with many instead imposing unlawful blanket rules whereby all contractors are deemed caught by IR35 without receiving an assessment. <ul style="list-style-type: none"> <li>A survey by the Freelancer and Contractor Services Association (FCSA) found that <b>50% of public authorities hadn't conducted IR35 assessments</b> for their contractors, while an additional 26% applied blanket rulings [8].</li> <li>A study by ContractorCalculator and the IHPA found that <b>60% of NHS locums were contentiously subject to blanket rules</b>, while 50% were informed that they wouldn't be hired unless they were on an umbrella company's payroll [6].</li> <li>Non-compliance within the NHS has resulted in its practices being the <b>subject of a judicial review</b> [9].</li> <li>Jolyon Maugham QC told a Commons Select Committee on BBC pay that non-compliance among public authorities is <b>forcing contractors into false employment</b>, stating: "They are saying everybody is an employee in circumstances where the law does not support that conclusion" [10].</li> </ul>	Almost all public authorities are compliant with the reform, having made assessments on a case-by-case basis. The £410m increase in PAYE and NI since the Off-Payroll rules began is evidence of heightened compliance.
Have the off-payroll rules made it harder for public authorities to hire contingent labour?	Public authorities have suffered notable difficulties sourcing contractors since the off-payroll rules were implemented. <ul style="list-style-type: none"> <li>According to research from the Association of Professional Staffing Companies (APSCo), <b>70% of recruiters claim contract placements in the public sector have dropped</b> [11].</li> <li>An August 2017 study conducted by ContractorCalculator found that 27% of contractors left the public sector after the reform went live, 38% of whom couldn't be replaced [12].</li> <li>Harvey Nash also found that 49% of contractors surveyed now exclusively seek contract opportunities in the private sector [13].</li> <li>The IFF study noted that <b>32% of central bodies had reported struggles in filling contractor vacancies</b> [7].</li> </ul>	The reform has not made it harder for public authorities to fill vacancies.
Has the reform resulted in an increase in contractor rates?	There is substantial evidence pointing towards a significant increase in contractor rates following the implementation of the reform. <ul style="list-style-type: none"> <li>APSCo found that <b>45% of recruiters reported increasing charge rates for contractors in the public sector</b> [11].</li> <li>Harvey Nash found that 42% of contractors claimed to have increased their rates to counter the tax increase caused by their deemed employment status [13].</li> <li>The IFF also acknowledged that <b>28% of central bodies reported increases in gross hourly rates</b> [7].</li> </ul>	For the majority of public authorities, the reform has not resulted in an increase in rates charged by contractors.
Have public sector authorities and projects suffered as a result of the reform?	Many high-profile organisations and projects, including National Rail and HS2, experienced difficulties following the reform, while staff shortages within the NHS have been intensified. <ul style="list-style-type: none"> <li>ContractorCalculator found that <b>71% of projects were delayed or cancelled in the immediate aftermath</b> [12].</li> <li>An October report by Transport for London attributed a project delay of more than three months to a significant number of contractors leaving following the reform [14].</li> </ul>	The reform has had no negative effects on the labour market, and changes in public sector recruitment were due to natural fluctuations in the workforce.

Can CEST be trusted to help hirers accurately determine IR35 status?	<p>No. There is a growing body of evidence demonstrating that CEST is not fit for purpose.</p> <ul style="list-style-type: none"> <li>• HMRC has acknowledged that CEST assumes mutuality of obligation (MOO) [15] – a key factor when assessing IR35 – to be present in all contractor engagements. This is incorrect.</li> <li>• <b>Barristers and IR35 legal experts have advised that CEST cannot be trusted to give an accurate representation of employment status [15].</b></li> <li>• In a letter to the Financial Secretary to the Treasury, the Institute of Chartered Accountants in England and Wales (ICAEW) advised that CEST was not suitable for use in the private sector [16].</li> <li>• <b>HMRC has also conceded that it has no detailed evidence to support its claims regarding the accuracy of CEST [5].</b></li> </ul>	CEST is aligned with employment case law underpinning IR35.
Has the reform improved compliance with IR35?	<p>Not necessarily. There is evidence to suggest that this scenario is incentivising more contingent workers to engage in tax avoidance schemes.</p> <ul style="list-style-type: none"> <li>• The Times found that <b>recruitment agencies are encouraging contingent workers into non-compliant umbrella loan-based schemes to counter the tax loss caused by the off-payroll rules</b>, with new schemes continuing to emerge [17].</li> <li>• As many as one in ten companies managing the payrolls of locum workers – roughly 60 of the 550 schemes in operation – are being investigated by HMRC for operating outside tax rules [18].</li> <li>• This has prompted a <b>leading UK medical recruitment agency to write to 30,000 locums, warning of the perils of these schemes [19].</b></li> </ul>	The reform has improved compliance with IR35. The fact that there are now more contingent workers engaged on public authority or umbrella company payroll demonstrates this.

## References

1. [Comparing taxes: contractors versus employees](#), April 2018, ContractorCalculator.
2. [Good work: the Taylor review of modern working practices](#), July 2017, Department for Business, Energy & Industrial Strategy.
3. [Can umbrella companies deduct employer's NI lawfully?](#), April 2018, ContractorCalculator.
4. [Jensal Software Limited v Revenue & Customs.](#)
5. [HMRC holds no detailed evidence to prove CEST accuracy claims, reveals FOI requests](#), April 2018, ContractorCalculator.
6. [NHS survey: patient care services in crisis as IR35 reforms take their toll](#), November 2017, ContractorCalculator.
7. [Off-Payroll Reform in the Public Sector: HMRC Research Report](#), May 2018, IFF Research.
8. [Legal challenges to IR35 public sector reforms seem inevitable](#), May 2018, FCSA.
9. [IR35: new judicial review against NHSI due to incorrect IR35 assessments](#), October 2017, ContractorCalculator.
10. [Oral evidence: BBC pay](#), March 2018, Digital, Culture, Media and Sport Committee.
11. [Public sector bearing brunt of new tax rules](#), October 2017, APSCo.
12. [Public sector IR35 reforms survey: projects crippled by contractor exodus](#), September 2017, ContractorCalculator.
13. [Harvey Nash IR35 Sentiment Report](#), Harvey Nash Recruitment Solutions.
14. [TfL Investment Programme Report – Q1, 2017/18](#), Transport for London.
15. [HMRC deliberately omitted key IR35 case law from CEST tool, reveals NHS webinar](#), October 2017, ContractorCalculator.
16. [ICAEW representation 40/18: modern working practices and off-payroll working](#), April 2018, ICAEW.
17. [Nurses are next on taxman's hitlist](#), February 2018, The Times.
18. [Steer clear of 'too good to be true' payroll schemes](#), May 2018, The Times.
19. [Health warning as staff face bills for back tax, May 2018](#), The Times.