



ICAEW REPRESENTATION 127/16

TAX REPRESENTATION

RESPONSE TO OFF-PAYROLL WORKING IN THE PUBLIC SECTOR: REFORM OF THE INTERMEDIARIES LEGISLATION PUBLISHED 26 MAY 2016

ICAEW welcomes the opportunity to comment on the consultation document [Off-payroll working in the public sector: reform of the intermediaries legislation](#) published by HM Revenue & Customs on 26 May 2016.

This response of 18 August 2016 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

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INTRODUCTION

1. We welcome the opportunity to respond to the proposals in the consultation, [Off-payroll working in the public sector: reform of the intermediaries legislation](#), published by HMRC on 26 May 2016.
2. The proposals announced in Budget 2016 are that from April 2017, the government will make public sector bodies (PSBs) and agencies responsible for operating the tax rules that apply to off-payroll working in the public sector. The rules will remain unchanged in the private sector.

MAJOR POINTS

3. We are concerned that PSBs are likely to be more risk averse than personal service companies when assessing whether or not a particular contract is caught by the IR35 legislation. This will result in the IR35 rules being applied more frequently and in cases where tax law does not indicate employment status.
4. While we consider that this proposal might work where a contract is directly between the PSB and the personal service company (PSC), moving the responsibility away from the PSB where an agency is involved would make it increasingly difficult to establish the full and correct facts of how the engagement is implemented. The decision should remain with the PSB.
5. The list of public bodies caught by the Freedom of Information Act definition is lengthy and comprehensive. It is possible that the intermediary nearest to the PSC may not actually know that the client at the top is on this list. This problem could be resolved by imposing a requirement on the PSB client to tell the worker and the intermediary paying the worker of its PSB status.
6. We are not convinced that the online tool proposed by HMRC will be sufficiently accurate to negotiate the complexities of the distinction between employment and self-employment.

GENERAL COMMENTS

7. The main proposal in the consultation only relates to work performed for public sector bodies. It would move the liability for making the determination about whether the intermediaries rules apply, and also for paying any associated tax liability, from the PSC to the public sector body or agency or other third party closest in the chain to the PSC. ICAEW considers that while this might work where the contract is directly between the PSB and the PSC, moving the responsibility away from the PSB where an agency is involved would make it increasingly difficult to establish the full and correct facts of how the engagement is implemented.
8. One of the practical problems when implementing the existing rules, is that it can be very difficult for the PSC to obtain a copy of the contract between the client and the agency/next intermediary down the chain. If there is a chain involved this problem would simply be replicated for the agency nearest to the PSC under the current proposals
9. If the responsibility and liability rest with the PSB, there is a practical difficulty that the departments responsible for procurement, payroll and where the worker is actually working may be remote from one another. In such cases, those involved may not even realise that the relationship is one which needs to be considered for the PSC legislation. It may also be difficult to obtain a copy of the contract in time to apply RTI in cases where it is felt necessary to put the worker on the payroll.

10. It is possible that due to a lack of expertise and/or to save administrative costs and to manage risk, some PSBs will adopt a blanket rule that all PSC workers must be put on the payroll, even where IR35 may not apply. The consequences would be:
 - cost increases to PSBs, or
 - use of an agency to by-pass the rule.
11. Where workers are in greater supply, PSBs taking on workers using an agency often set a fixed price for work. Under these proposals, overcautious operation of PSC rules by the agency will usually see the worker effectively forced to suffer the cost of the employers' NIC as the agency seeks to retain its profit margin.
12. If working for a PSB is perceived to be taxed more harshly than for private sector companies, PSBs may find it harder to attract more specialist talent or will have to pay more for it.
13. This change does not give employment rights any more than the PSC legislation does currently. This will be very confusing and even misleading for workers affected.
14. People engaged through PSCs who work in both the public and private sectors will find their tax affairs more complicated.

ANSWERS TO SPECIFIC QUESTIONS

Definition of the public sector

Question 1 : Are there other easily understood definitions that work better than the FOI Act and the FOI (Scotland) Act?

15. In view of the proposal being considered, these definitions seem most relevant. We are however concerned that agencies and workers will not always be aware that the client is within the FOI Act or FOI Act (Scotland). Appendix B runs to more than 40 pages of double columned lists and some of those organisations on the list will be surprising to agencies and workers.
16. If these proposals are taken forward in any way, it will be essential that the PSB has an obligation to inform any agency through which it contracts and any worker it engages through a PSC that it is a PSB. It should also carry the burden for proving that this information has been given throughout the engagement chain.

Question 2: Are there any public sector bodies which are not covered by the FOI acts which should be included in the definition for the proposed rules?

17. Possibly, although the fact that this question is being asked indicates the difficulty of applying this definition in practice. It appears the Companies House is not on the list.

Question 3 : Should private companies carrying out public functions for the state be included in this definition? Why?

18. No. The change being proposed would already segregate the market into work done for PSBs and work done for others. This will add enough complications without also requiring agencies and workers to consider whether they are performing a public function, which itself will need to be defined.

Office holders

19. IR35 can apply where there would be a relationship of employment in the absence of the intermediary, but it can also apply where the worker is an office holder.

20. The definition of the term 'office holder' can cause employment tax legislation to apply to relationships that Parliament did not envisage. For example, a bishop in the Catholic church is an office holder. Master mariners who are share fishermen are self-employed despite being in the 'office' of ship's captain. The role of auditor is an office and a professional services organisation may be appointed to undertake a statutory duty such as an audit.
21. To date, HMRC's view has been that the rules do not apply when a company engages another firm as auditor and there is no requirement for an individual's personal services. It is generally agreed that both in respect of auditors and other professional engagements, it is unlikely that Parliament intended fees paid to professional services organisations to be subject to PAYE and NIC. To put this beyond doubt, the simple solution which would remove any possible concern would be to exclude certain roles from the definition of an office for tax and NIC purposes, or narrow the definition to roles that Parliament wishes to be caught. The obvious place to do this would be at s 5, Income Tax Earnings and Pensions Act 2003.

Question 4: Are there any public bodies caught by this definition who would face particular impacts which should be considered?

22. No further comment.

Question 5 : Are rules needed to ensure that engagers have the information they need to make the decision? If so, what should they be?

23. If these proposals are taken forward in any way, it will be essential that the PSB has an obligation to inform any agency through which it contracts and any worker it engages through a PSC that it is a PSB. It should also remain responsible for proving that this information has been given.
24. Knowing that the organisation is on this list will be important for
- The staff initiating the contract at the engaging PSB
 - Any agency in the chain between the engager and the PSC of the worker
 - The worker

5% deduction

Question 6: How would accounting for the 5% allowance work in practice?

25. The example of the 5% deduction (page 19) is a good illustration of how the calculation of both VAT and corporation tax will be more difficult to understand. VAT is charged on the gross sum as usual which will be seen by many as counter intuitive.
26. As explained in the consultation document, the purpose of the 5% deduction is to allow for the general expenses of running a business. In essence, the additional tax being collected where it is decided that IR35 applies is employers' NIC. Clearly, if the proposals are implemented and the liability for this is then paid by the engager, allowing the costs of running a business as a deduction in calculating employers' NIC becomes irrelevant.

Question 7: Are there business costs specific to PSCs that are covered by the 5% that aren't covered under the usual business expense rules?

27. HMRC's proposals do not explain how company pensions will be dealt with.
28. The pension cost is allowed as a deductible item under step 5 of the deemed payment calculation. The pension will be paid by a different party to the one calculating the deemed payment, and so there will be problems both of confidentiality and of verification. Moreover,

there may be several PSBs or their agencies responsible for calculating deemed payments. This leads to practical problems such as how the pension contribution will be allocated between them and how under or over payments would be dealt with.

29. Similar problems could apply to capital allowances and insurance payments.

Making the decision

Question 8: Does the first part of the test work to quickly rule out engagements that are clearly out of scope?

30. The first question, 'Is the worker hired through an agency?', will make many PSBs immediately see the benefit both in terms of reduced administration and also in managing their risk, of engaging workers through an agency rather than directly. We do not think this is the aim of this policy proposal and is one of the reasons why we do not think the decision and liability for taking the decision should flow away from the PSB client.
31. In the second question, we do not know where statute introduces a 20% test and we believe it is wrong to attach such a degree of importance to it as compared to existing case law tests .
32. Where a contract is for labour and materials, normal commercial practice would be for the worker to quote and invoice for the work as a single figure. The cost of materials will depend on any discounts the contractor is able to secure and will be a competitive element within his or her tender. This is not usually disclosed.

Question 9: Are these the right questions in the right order of priority?

33. No. These questions oversimplify the issues. Control is about how, what, when and where the work is done.
34. In its guidance on the 'Definition of supervision, direction or control for employment status purposes', HMRC says

'Control is someone dictating what work a person does and how they go about doing that work. Control also includes someone having the power to move the person from one job to another.'
See
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/290051/Definition_of_Supervision_Direction_or_Control_with_supporting_examples.pdf
35. The attempt to make it easier for non-tax professionals to use the rules by merely ignoring some of the rules, while understandable, is unlikely to succeed.

Question 10: Are the questions simple to understand and use?

36. They are simple to understand and use but they only consider some of the relevant rules. At best this makes them less useful than they should be and at worst unreliable and potentially misleading.

Question 11: Do the two parts of the test give engagers certainty on day one of the hire?

37. No. If it was possible to define a simple gateway test for such a complex area, it would have been done before. Almost certainly the majority of engagements will need to move on to use the online tool.

Question 12: How can the organisation completing the tests ensure they have the information to answer the questions?

38. Wherever the responsibility for completing the tests lies, access to the contract and most importantly to information about how the contract is actually carried out is essential.
39. The parties best placed to understand the terms of the engagement are the PSB and the PSC. An agency will have very little information and will most likely be risk averse and simply default to putting the worker onto a payroll, usually one run by an umbrella.
40. Where the intermediary is further down the contractual chain, they are most unlikely to have access to the relevant person within the PSB for information or a copy of the contract. The worker is highly unlikely to have the necessary information, which is one of the problems of the existing system. It can be very difficult to obtain a copy of a contract between an agency and its client where the worker is not a direct party to that contract.
41. We consider that in such cases, the responsibility would be better left with the PSB, although as stated earlier, this too suffers from problems of its own and could impact on the availability of quality specialist staff to undertake PSB contracts.

Question 13: How could the new online tool be designed to be simple and straightforward to use?

42. While we have not been involved in creating or testing the new tool, we are not convinced it will be possible to design a tool that is sufficiently simple and straightforward to be sufficiently reliable in any given situation.

Transfer of liability

Question 14: Where should the liability for tax and National Insurance (and penalties and interest where appropriate) fall when the rules haven't been applied correctly?

43. If these rules are adopted, the liability should follow the responsibility. So if the PSB fails to confirm its status, the PSB should be liable. It should also be able to prove that it has confirmed its status.
44. If the liability for taking the decision about whether IR35 applies is also left with the PSB, rather than passing down to the agency, which we do not think should happen, then it should also be liable for this.
45. The consequences of this are likely to be that workers would rather be put onto the payroll under a temporary employment contract, so also qualifying for associated employment benefits. Without this added benefit, they stand to lose money with no compensation. Workers who have a choice to work elsewhere would most likely do so.

Question 15: Should the liability move to the PSC where the PSC has given false information to the engager?

46. No. This could be used by the PSC to take back the decision which would be contrary to the policy intent.

Costs

Question 16: What one-off and ongoing costs and burdens do you anticipate will arise as a result of this reform?

47. We do not have information available to quantify the costs, but it is almost certain that this will be confusing and that costs will increase.
48. Public sector costs will rise. We have said elsewhere in this response that PSBs are very much more risk averse than PSCs. Adding employers' NIC to the contract cost will increase employers' NIC received by the Treasury but will also increase public sector spending. Net

income to the Treasury will therefore not change significantly, but administrative costs to the public sector will increase.

49. In the future, specialist professional contractors may decide to work only in the private sector or, if they do decide to undertake work for PSBs, will increase their charges to them.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see via <http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax>).