



LESSONS FROM IMPLEMENTING IR35 REFORMS

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Text of evidence submitted on 11 February 2022 to the *Lessons from implementing IR35 reforms* inquiry launched by Public Accounts Committee on 12 January 2022 a copy of which is available from this [link](#).

For questions on this response please contact our Tax Faculty at taxfac@icaew.com quoting REP 38/22.

The main lesson that should be drawn from IR35 and any difficulties in implementing the reforms in 2017 and 2021 is that the fundamental problems underlying the taxation of work remain. The off-payroll working problem will only be resolved permanently if the advantages of tax and NIC arbitrage, especially the cost of employer NIC, are removed. This could be achieved if the total amount of tax and NIC payable by individuals and the engagers of workers was the same (or more closely aligned) across all sources of income and did not vary depending on employment status or the type of engagement.

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KEY POINTS

1. The main lesson that should be drawn from IR35 and any difficulties in implementing the reforms in 2017 and 2021 is that it is a sticking plaster solution which does not address the root cause of the off-payroll working problem. The fundamental difficulties underlying the taxation of work remain and the off-payroll working problem will only be resolved permanently if the advantages of tax and national insurance contributions (NIC) arbitrage, especially the cost of employer NIC, are removed.
2. This could be achieved if the total amount of tax and NIC payable by individuals and the engagers of workers was the same (or more closely aligned) across all sources of income and did not vary depending on employment status or the type of engagement. Ultimately, these problems can only be properly addressed by an informed debate about how we should tax work and the extent to which the tax system should distinguish between the employed and self-employed.

GENERAL COMMENTS

3. The main lesson that should be drawn from IR35 and any difficulties in implementing the reforms in 2017 and 2021 is that the fundamental problems underlying how work should be taxed remain. Solving this really requires an informed national debate. In the absence of such a discussion over many years, any solutions proposed are unlikely to address the underlying problems and any measures are unlikely to be sustainable.
4. Trying to classify employees, gig workers and the self-employed as either employed or self employed for tax and NIC purposes is not a sustainable solution. A long term rethink is needed.
5. The off-payroll working (OPW) problem will only be resolved permanently if the incentives to arbitrage between different tax and NIC rates depending upon whether a worker is classed as employed or self-employed are restricted or removed.
6. This could be achieved if the total amount of tax and NIC payable by individuals and engagers of workers was the same across all sources of income and did not vary depending on employment status or type of engagement, or was more closely aligned. The debate would need to include whether the genuinely self employed should have a reduced tax/NIC bill, and, if so, what the reduction should be. We appreciate that this is a major challenge, especially given that these differences have existed now for a number of years. But absent an informed discussion, it is difficult to see that any consensus can be built about how the existing system could be reformed.
7. It is now nearly five years since Matthew Taylor, in his welcome *Good Work* report of July 2017, recommended that the level of NIC paid by employees and self-employed people should be moved closer to parity. In its *response* in February 2018 the government said that it had no plans to revisit this issue, but it was right only to consider making changes to this area once it has 'carefully considered this in the wider context of tax, benefits and rights over the longer term'.
8. Since February 2018 the government mainly through BEIS has been making wider reforms in the labour market, but little progress has been made in considering the tax and NIC implications.
9. We appreciate that reforming tax and NIC would be a fundamental step and would need to be linked to benefits and rights, but, until this nettle is seized and considered holistically, any solutions such as IR35 will continue to do little more than nibble at the edges of the underlying problem while imposing costly compliance burdens on businesses.
10. Such burdens are not needed at any time, let alone currently, when the world's economies are trying to recover from a pandemic, and UK plc needs a tax system which, following Brexit, encourages growth and an efficient, productive and flexible workforce.

COMMENTS ON IMPLEMENTATION

11. The 2017 public sector provisions went live on 6 April 2017 before the law had been enacted, official guidance was ready and major policy decisions and operational processes had been resolved. The government delayed extending IR35 reforms to the private sector for a year until 6 April 2021 owing to Covid-19. This delay was welcome, as it provided time for the policy to be improved, in response to representations, and the legislation to be enacted before the 6 April 2021 implementation date, rather than after as for the 2017 reforms. It also gave more time for HMRC, again in response to representations, to update its guidance, which was still incomplete by 6 April 2021.
12. Throughout the run up to and following the 2017 and 2021 changes, HMRC undertook a lot of engagement work with representative bodies who, based on a practical working knowledge of industry, flagged potential pitfalls and lacunae. However, the need to get the reforms in place by the implementation date left insufficient time for HMRC to be able to address concerns and get the rules, processes and guidance right first time.
13. The IR35 reforms are just one example of how tax and NIC policy roll-out overlooks the mechanics of implementation and practical issues. The formulation of legislation needs to change so that implementation and practical issues, including software updates, are considered at an early stage in policy development and legislation-making, not as an afterthought.

Ways in which HMRC tried to mitigate risks for parties in the labour chain

14. HMRC issued guidance to try and fill gaps in the legislation. However, as an example, the guidance for the 2017 reforms was not published until February 2017 and could at best be treated as provisional even when the reforms came into effect on 6 April 2017, because the legislation was not enacted until 27 April 2017. Many changes had to be made to the guidance after the date that the 2017 reforms came into effect.
15. Determining employment status is very difficult. There is no simple formula but instead there are rules based on past court cases, and even experienced judges can disagree on employment status given the same facts.
16. HMRC updated its check employment status for tax (CEST) tool in December 2019. It still does not cover all the main tests for employment status as interpreted by the courts, notably specific (ie, master/ servant) mutuality of obligation, nor in 20% of cases reaches a decision, which means that engagers and advisers have to spend additional time in arriving at an employment status determination that is likely to be accepted by HMRC.
17. Consequently, a major risk for all stakeholders is additional PAYE income tax and NIC (and associated interest and penalty) liabilities where the employment status of workers has been corrected. Nearly five years after the 6 April 2017 reforms went live, the way in which tax and NIC liabilities should be reallocated to the respective parties in the labour chain when mistakes are corrected and consequential interest and repayment supplement is still not agreed between HMRC and stakeholders.

Impact on engagers and workers

18. The reforms increased uncertainty for engagers and has increased the direct costs and compliance costs of hiring contractors working via intermediaries such as personal service companies. Direct costs would have risen because many workers providing their services through intermediaries would have been reclassified as deemed employees, resulting in engagers having to bear the additional costs of employer NIC and apprenticeship levy. Reports in early 2017 suggested that workers' rates were increasing by around 20% to discourage them from instead choosing private sector contracts outside the new rules.
19. In order to minimise risk, many public sector engagers initially implemented blanket 'inside OPW' employment status rulings. However, as engagers must consider the specifics of every case, and blanket rulings, save for groups of workers with the same or very similar contracts, do not come within the definition of taking reasonable care, they had to change tack.

20. Many engagers have had difficulty in correctly applying the rules, for example in the public sector HMRC last year collected back taxes and NIC from DWP of £87.9m, Home Office £29.5m plus penalties of £4m, and HM Courts & Tribunals Service £12.5m.
21. Some workers have had their take home pay reduced, some because of having been reclassified as within OPW but others because the organisations responsible for paying the workers' personal service companies have deducted employer NIC and apprenticeship levy even when this has not been permitted under the contract. Other workers employed by for example umbrella companies run by unscrupulous offshore operators have been sucked into disguised remuneration loan schemes while.
22. Workers with stronger bargaining power, eg with specialist knowledge or in more senior positions, can negotiate higher rates of pay to ensure that their take home pay is not reduced if subjected to PAYE. In the private sector businesses have reduced risk by taking on fewer contractors who work via personal service companies and outsourcing to agencies that they trust, which may have the workers on their own payrolls or supply them via umbrella companies.

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 <https://goo.gl/x6UjJ5>).