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"Onshore Employment Intermediaries: False Self-Employment" Consultation

Response from the Employment Lawyers Association

4 February 2014

1. Introduction

1.1 The Employment Lawyers Association ("**ELA**") is a non-political group of specialists in the field of employment law and includes those who represent Claimants and Respondents in the Courts and Employment Tribunals. It is therefore not ELA's role to comment on the political merits or otherwise of proposed legislation, rather to make observations from a legal standpoint. ELA's Legislative and Policy Committee is made up of both Barristers and Solicitors who meet regularly for a number of purposes including to consider and respond to proposed new legislation.

1.2 A sub-committee was set up by the Legislative and Policy Committee of ELA under the chairmanship of James Warren (Field Fisher Waterhouse LLP) to consider and comment on the "Onshore Employment Intermediaries: False Self-Employment" consultation paper. Its report is set out below. A full list of the members of the sub-committee is annexed to this report.

2. Overview

2.1 Government has set out a well defined policy aim: stamping out the use of intermediary arrangements to facilitate false self-employment. However, ELA is concerned that the proposed amendments to section 44 ITEPA (the "**Draft Legislation**") to achieve that aim are too blunt, and that it will have a much broader and deleterious effect upon a wide range of legitimate business models.

2.2 ELA is also concerned that the present proposals, if implemented, would lead to significant uncertainty and additional complexity, at odds with the Government's objective of a simpler test for determining when remuneration must be treated as earnings from employment.

2.3 When considering the proposed amendments ELA has also had regard to the existing "agency" legislation and our comments in some respects address issues which might be raised with the current provisions but that, perhaps to date, have been less significant given their narrower scope.

2.4 ELA comments reply to the specific questions posed, and are divided accordingly. However, key general points are summarised below:

(a) The new test to govern when an "agency" is liable to operate PAYE in respect of individuals performing or providing services is removed from the employment status test used for the purposes of other employment legislation. Except when engaged directly by the client, whether someone is self-employed for tax purposes will now rest essentially on one concept (whether or not there is "supervision, direction or control"). Additionally, the supervision, direction or control may be exercised by "any person". Many different parties, from the client to any employment business in a long contractual chain, could exercise some such supervision, direction or control.

(b) The Consultation Document remarks that the new proposals "*will put someone who is engaged by or through an intermediary in the same position as someone who is engaged directly.*" The opposite is in fact the case, as individuals will be in a completely different place as to tax status depending on whether they engage directly with clients or via an intermediary. The Draft Legislation will have the confusing effect of creating a completely separate regime to govern the treatment of individuals working through intermediaries from those who are not, when conceptually the employment status analysis should be the same.

(c) Where there is more than one employment business or "agency" between the individual and the ultimate client, the Draft Legislation is unclear as to which one has the obligation to deduct PAYE and NICs. This is because each intermediary is legally the client for the provision of services to it, as well as the provider of services to its own client. As it stands, it seems as though any and all of the employment businesses in the chain could potentially be liable.

(d) Due to the uncertain nature of the proposals, we envisage there would be satellite litigation to gain greater clarity; in particular as to which party in the chain is liable if PAYE / NICs is not correctly deducted.

(e) ELA envisages significant commercial difficulties arising as a result of the Draft Legislation's wider scope encompassing all sorts of business to business relationships, including those that we do not consider were intended to be captured, such as where no employment business or intermediary (as the terms are commonly understood) is in the contractual chain.

(f) The Consultation Document suggests that individuals who were formerly treated as self-employed would now be employees / workers and therefore gain the benefit of employment rights. However, this will not be the case for many basic employment rights (e.g. the right to claim unfair dismissal or redundancy compensation). This means that individuals will have the burden of PAYE / NIC deductions without necessarily obtaining the corresponding benefit of employment law protections (although they may be under that misapprehension).

(g) One of ELA's key concerns is the timing of the proposed implementation. The proposals as drafted would have a significant impact on the business model of employment businesses and those currently treating themselves as self-employed. The proposed implementation date of 6 April 2014 does not allow sufficient time for these proposals to be considered and correctly implemented. If the implementation date is not delayed, it seems inevitable that there will be confusion about the proposals and that employment businesses will struggle to implement them correctly.

3. Practical and commercial difficulties with the proposed definition of 'employment intermediaries'

3.1 **Question 1: Would the definition of intermediary as proposed in the legislation cause any practical difficulties e.g. to genuine commercial arrangements? Please provide details and examples.**

3.2 **Question 2: Are there likely to be any commercial difficulties with the proposed definition of employment intermediary? If so please say what they are likely to be and provide examples.**

(a) Consultation questions 1 and 2 are similar and accordingly this response is directed to both questions.

(b) ELA does perceive commercial difficulties with the proposed definition of employment intermediary. It is apparent from the Consultation Document that the primary target of the proposed legislation is those employment businesses offering engagement models to individuals which they know are inappropriately branded as self-employment, in order to circumvent the proper payment of PAYE / NICs.

(c) ELA considers the construction of section 44 of the Draft Legislation and then goes on to identify examples of how this could cast a much wider net than may be intended. This could cause considerable difficulties even for employment businesses which are trying to comply wherever possible with the obligations to deduct PAYE and account for NICs as required.

3.3 **The definition of "agency" at section 44 (1)**

(a) Whilst the term “intermediary” does not appear in the Draft Legislation, the relevant definition is at the proposed section 44(1)(b) and applies where:

“*there is a contract between the client and a third party (“the agency”) under or in consequence of which:*

(i) the services are provided; or

(ii) the client pays, or otherwise provides consideration, for the services."

(b) The term "agency" is not further refined and so is not limited to an employment business as defined under the Conduct of Employment Agencies and Employment Business Regulations 2003. This means that the legislation could potentially impact upon a wide range of contractual situations which have not historically been understood to be captured by the agency legislation at Chapter 7 of Part 2 of the Income Tax (Earnings and Pensions) Act 2003 ("**ITEPA**"). It is in this wider context envisaged by the current drafting that ELA uses the term "agency" throughout this response.

3.4 **The new wording regarding "personal service" at section 44 (1)**

(a) The existing legislation requires an obligation of personal service under the terms of an agency contract to provide the services personally to the client. ELA acknowledges that substitution clauses can be abused and that they may be routinely inserted into contractual arrangements where, in practice, personal service is required. However, ELA is concerned that the proposed wording is not satisfactory in targeting the intended mischief.

(b) The proposed wording not only removes the requirement for there to be any contract between the individual and the "agency", but also extends the definition of "worker" to someone who "is personally involved in the provision of" services. This cannot mean the same thing as "personally provides" the services since, if it did, its inclusion in the definition at section 44 (1) would be unnecessary.

(c) This opens the possibility to the Draft Legislation applying to someone engaging in activity ancillary to the services, in some sort of support capacity to the individual/company actually providing the services to the client, and who has no contract with the "agency" as defined. It is conceivable that the "agency" which would have a liability for meeting the PAYE/NIC obligations for this person, whom they may not even know exists.

3.5 **The definition relating to the right of or actual supervision, direction or control, and the presumption that this exists**

(a) In the classic case on employment status, ***Ready Mixed Concrete (South East) Limited v Ministry of Pensions [1968] 2 QB 497***, MacKenna J said the following:

"*Control includes the power of deciding the thing to be done, the way in which it shall be done, the means to be employed in doing it, the time when, and the place where it shall be done. All these aspects of control must be considered in deciding whether the right exists in a sufficient degree to make one party the master and the other his servant. The right need not be unrestricted.*"

(b) This case provides a neutral burden on the issue, whereas the proposed presumption in the Draft Legislation places the burden of proof squarely on the "agency" and the individual arguing for self-employed status.

(c) Further the proposed statutory definition (which is now all that would be relevant for the self-employment test in this context) provides for any of the three elements of supervision, direction or control to suffice to bring the individual within scope. ELA has a concern that it would be all too easy for one of these three elements to be identified to some degree so that it will be extremely difficult for any "agency" or individual to be sure whether self-employment would apply. For example, an obligation to conduct the services during certain operating hours, in compliance with all health and safety obligations, and in line with certain client policies such as anti-bullying and harassment are all common obligations placed on self-employed contractors. Whilst HMRC guidance may be helpful, ELA's view is that it can only be guidance and the history in this area is that seldom are the facts identical in any two cases and each must be considered on its of merits on a case by case basis. This leaves the "agency" / individual trying to prove a negative against an uncertain legal background.

(d) Further, as the supervision, direction or control only needs to be operated "*by any person*", if anyone within the chain, from the client to any employment business involved, has a measure of supervision, direction or control over the individual, the arrangements will fall outside of self-employment. This seems overly wide.

(e) The proposed new test very significantly narrows the test envisaged in Ready Mixed Concrete, as it ignores a great many factors that have been an established element of considering employment status for decades (discussed in more detail at paragraph 3.6 below).

3.6 **The absence of other elements which form part of the common law consideration of employment status**

(a) Long established case law has identified numerous other relevant factors relating to employment status. For example in ***Hall (HM Inspector of Taxes) v Lorimer [1994] IRLR 171***, the following factors were considered relevant:

- Who provides and maintains the tools or equipment used;
- Whether the person hires their own help;
- The degree of financial risk adopted;

- The degree of investment in and management of the business; and
- Whether the individual has the opportunity to profit from their own good performance.

(b) None of these would be relevant at all under the Draft Legislation, yet can be very strong markers for self-employment in any number of genuine business-to-business arrangements, e.g. self-employed IT consultancies subject to large insurance risks and commercial terms for delivery of projects under which financial reward could fluctuate significantly, and who may engage their own sub-contractors to some degree during a project.

(c) At paragraph 1.9, the Consultation Document remarks that the new proposals "*will put someone who is engaged by or through an intermediary in the same position as someone who is engaged directly*." ELA's view is that in fact the opposite will be true, in that those engaged via an intermediary, doing exactly the same work on exactly the same terms as someone engaged directly by the client, will now be in a much more disadvantageous position than had they been engaged directly by the client when it comes to establishing self-employed status for income tax purposes.

(d) For someone engaged directly by the client, the established common law test set out in Ready Mixed Concrete would apply – control, obligation of personal service, mutuality of obligation and various other factors, all with a neutral burden. For the same person engaged via an intermediary, only control will apply (or, more accurately, the right of or actual supervision, direction or control) and there will be a presumption against the individual. The difference is remarkable.

(e) It is difficult to see why a different test should be applied to engagements of an individual via an intermediary or engagements of an individual by the client directly. By treating the two differently the Draft Legislation is penalising employment businesses, who will have to deduct higher levels of employer's NICs. The employment business serves a useful commercial function: enabling clients to find flexible labour in the market place. Making the employment business model harder to operate may push clients to engage individuals directly or to make use of other business models (such as employment agencies). This could, in turn, create inefficiency and higher market costs.

(f) ELA recognises that one of the advantages of the Draft Legislation is the simplicity of the test. By reducing the test to one, significant factor, a potential benefit could be that it is easier to determine whether or not an individual is properly characterised for tax purposes as self-employed. However, the downside is in the overly wide scope of supervision, direction or control as drafted and as per the examples given in the guidance and the resulting confusion and complexity of administering two tests (one for tax purposes and one for employment purposes).

3.7 **Some examples of the potential commercial difficulties which may follow**

We have set out below example 3 from Annex B of the Consultation Document.

Worker C approaches a high street employment business (EB1) who is advertising for painters to work on a major refurbishment scheme. EB1 inform worker C that he can start work but he must contract through a further company (Intermediary EB2) which will deal with the payroll issues and make payment to worker C. Worker C contracts on a self-employed basis with EB2 and EB2 contracts with EB1 to supply worker C to the client.

Worker C reports to the client as he is required to provide painting services as directed by the client. During the first week worker C paints rooms on the ground floor of one of the office buildings. The client then moves worker C to another building during the second week where work is falling behind. In the third week worker C is told to return to the original office building where decorating work can now start on the second floor. The client has control over what worker C does and can direct him at any particular time as to the work and the order in which the work had to be done. The client dictated the manner in which the work was undertaken.

The payment route is from client to EB1 then to EB2 then to worker C. EB1 & EB2 deduct their fees and EB2 pays worker C.

In this scenario control is clearly being exercised by the client. EB1 is therefore required to operate PAYE and deduct income tax and NICs in relation to payment received for work done by worker C.

(a) The facts of example 3 in the Consultation Document do not have to be much altered to illustrate the potential difficulties that could result from the proposed change in relation to personal service and substitution. For example, if worker C, who is engaged on a self-employed basis, wishes to be on-site for part of the week but elsewhere in the rest of the week and is permitted to engage his own sub-contractors in helping him to fulfil the contract. Let's say that worker C engages four different painters to help him carry out the work during the course of the contract while he is off-site.

(b) Under the definitions in the proposed section 44, it is irrelevant that Worker C does not need to provide personal service. He will be within scope whenever he is on site and "personally provides" the services to the client.

(c) Even when he is not on site, he may still be in scope because he might be said to remain "*personally involved in the provision of*" the services, by virtue of his engaging sub-contractors to undertake the services on his behalf and / or supervising them.

(d) Further, the four individuals who are providing the services in his absence have no contract with either of the employment businesses, EB1 or EB2, neither of which are likely to know anything about them at all, and will have no idea what Worker C is paying them or himself out of the monies paid to worker C.

(e) However, it would appear conceivable that EB1 would have to operate PAYE for worker C and the other individuals that worker C engages to fulfil his contractual obligations. EB1 would have these obligations notwithstanding that it has no idea when Worker C is on site, who he is using as sub-contractors, or what anyone is being paid.

(f) This creates an impossible burden on EB1 and if EB1 was involved with hundreds of contractors, with similar issues arising across its business, the implications are very far reaching. The enquiries and information gathering that would be required of EB1 to: (i) determine whether worker C was using sub-contractors and (ii) determine to what extent those sub-contractors were subject to supervision, direction or control are substantial.

(g) Further, in example 3 the control being exercised relates simply to which part of the building to paint and when. ELA doubts that this is or that it should be sufficient to satisfy the proposed control test in section 44 (2), but if it is sufficient and is extrapolated across all sorts of business sectors, it becomes difficult to conceive of many scenarios falling outside of the proposed section 44.

(h) It is noted that there is no information about whether worker C carries his own insurance, or supplies his own paint, brushes, ladders and other materials, all indicators of self-employment, but even if he does it would not alter the above analysis. These factors, which have historically been important in determining whether or not an individual is self-employed, now have no part to play in determining an individual's status as self-employed or employee / worker.

(i) If, however, worker C contracted directly with the client and utilised the four painters as described in ELA's revised facts above, there is plainly no obligation to provide personal service. Worker C would therefore be deemed self-employed because the issue would be determined under the Ready Mixed Concrete test, not section 44.

(j) Under section 44 of the Draft Legislation, worker C would himself be deemed an "agency" in respect of the individuals he engaged to provide the services to the client on his behalf, meaning the statutory control test in section 44 (and nothing else) would have to be used to assess whether worker C should be deducting PAYE in respect of those he engages. By the same analysis, it is quite possible that EB2 might be liable as the relevant "agency", on the basis that it is contracting to provide a service to its client EB1. The parties involved in any such scenario would clearly be left with significant uncertainty as to which of them might be liable.

3.8 **A further example in the construction industry**

(a) A client may engage a main contractor (not an employment business) who will then engage sub-contractors. As currently drafted, an individual sub-contractor or anybody working for the sub-contractor via the third party main contractor, providing personal services for the client of the main contractor, would fall within scope. The presumption of actual (or right of) supervision, direction or control “by any person” means the individuals are in scope regardless of whether the client, or main contractor or even the sub-contractor is exercising or has the right to exercise any one of supervision, direction or control.

(b) This would seem to take priority over the well established Construction Industry Scheme arrangements.

(c) The main contractor would find itself in the same position as EB1 in Example 3 discussed above.

3.9 **Partnerships**

(a) It would appear that section 44 of the Draft Legislation could capture partners in certain circumstances. A professional services firm will contract with its clients to provide particular services, and partners within that firm (regarded as self-employed) will either "*personally provide*" or be “*personally involved in the provision of*” the services to the client.

(b) The firm would appear to meet the definition of "agency" in section 44. The partner may meet the definition of "worker" in section 44. The partner's income will not be taxed as employment income aside from section 44, and therefore if the partner's remuneration can be said to be "in consequence of providing, or being involved in, the provision of, the services" (section 44 (1) (c)), it seems the firm may be obliged to apply PAYE to its partners. As the firm's income is wholly reliant upon the provision of services to its clients, where is the line drawn?

(c) The partner may well be subject to a right of or actual supervision, direction or control by "any person", which could be the firm and its internal and regulatory requirements, or the client under the terms of a service level agreement with the client dictating how the contract is to be performed.

3.10 **Where a PSC subcontracts**

(a) The complexity of the position of a PSC under the Draft Legislation can be demonstrated by a scenario where a client engages an employment business to source a specialist architectural PSC, which enters into a contract for services with the employment business. The PSC may itself sub-contract elements of the services, or matters ancillary to the provision of the services, or otherwise engage a self-employed individual to assist in some way which is directly related to the provision of the services by the PSC. It might be an engineer, perhaps a surveyor, or potentially any number of other categories of individual. It might even be a professional services partnership which utilises a partner to undertake the services which form part of the employment business' contractual obligations to the client, sub-contracted to the PSC. The individual performing the services on behalf of the PSC may be subject to the right of or actual supervision, direction or control by the client or the PSC (it could be "any person" under section 44(2) of the Draft Legislation).

(b) HMRC takes the view in its current guidance that section 44 would not generally apply to the owner of a PSC because he will be paid, at least to some degree, in dividends (although see ELA's comments at paragraph 5.5). However, in the above scenario, the employment business could be obliged to deduct PAYE and account for NICs in respect of the PSC's sub-contractors, notwithstanding that there may be no obligation to make any such deductions in respect of the owner of the PSC as he/she is paid by way of dividend. Conceivably this could extend to the partner of a firm engaged by the PSC to assist it in the performance of the services, depending on how that partner is remunerated by the firm, on the earlier example analysis.

(c) There will be no knowledge of the existence of the PSC's sub-contractor, or what that sub-contractor is doing, yet the agency may have an obligation to deduct PAYE / NICs.

(d) ELA stresses that all of the examples provided above would apply where no employment business was involved at all, having regard to the wide definition of "agency" under section 44. If the Draft Legislation is not intended to apply to PSCs, then it would be sensible to express this in the primary legislation and to include a definition of a "PSC". However, we do not understand the policy objective for treating PSCs different from employment businesses; whether an individual is engaged via a PSC or an employment business, if they are properly characterised as self-employed, surely they should be treated the same way.

3.11 **A business to business example with no employment business involved**

(a) Company A enters into a contract with Company B to undertake a mail shot of promotional material around a particular town. Company B engages 10 individuals on a self-employed basis to assist it in undertaking that mail shot. Those 10 individuals are paid a fee by Company B to deliver the promotional material. There is a degree of direction or control in that they are allocated particular postcodes. They are asked to deliver on a particular street on particular days and between particular times. The 10 individuals carry out some of the deliveries themselves, but also use four other people each to assist them on a self-employed basis. None of the fifty people involved is obliged to undertake the services personally. There is no employment business

anywhere in the contractual chain. In this example there is a contract between Company A and Company B. The 10 individuals and all the other individuals that they utilise to carry out the contractual obligations which Company B has to Company A are all personally providing or personally involved in providing those services. They are all subject to a degree of direction and control as to the manner in which those services are carried out.

(b) It seems that each and every individual involved in the provision of those services would fall within the proposed section 44 and that PAYE / NICs should be deducted. In this scenario, it may be that the liability to make this deduction falls on Company B although the Draft Legislation is also open to the interpretation that the liability falls on the 10 individuals who are acting as "agencies" in relation to the subcontractors. This is notwithstanding the fact that there was no obligation on any of the 10 individuals who entered into direct arrangements with Company B, or any of the additional forty individuals engaged by those 10 individuals, to carry out any of the services personally. It seems inconceivable that on a common law analysis of employment status any of these fifty individuals would be deemed employees of anyone for any purpose, including the existing section 44.

(c) This is an example of how the legislation as drafted could impose impossible legal obligations on a great variety of businesses, many of which are unlikely to be employment business or know anything about section 44 in the ordinary course of their business.

3.12 **Points for Consideration**

(a) Limiting the test to one of direction, supervision or control takes the concept of self-employment for income tax purposes far away from the existing employment status tests which have emerged through case law over many years. HMRC's own guidance on employment status includes many of the elements which have emerged out of case law through the years and it is striking that essentially all but one of those factors, i.e. control, will become irrelevant under the Draft Legislation.

(b) ELA's view is that the concept of substitution clauses amounting to a sham is well established and the Courts will readily dismiss such clauses as a sham where the factual analysis supports this. ***Autoclenz Ltd v Belcher and others [2011] IRLR 820 (SC)*** is a high profile recent example, but there are many others. In the light of this, therefore, ELA queries whether it is necessary to make such a radical change to the test for PAYE and NIC purposes having regard to what would appear to be a very great number of potential unintended consequences as the legislation is currently worded.

(c) ELA also has significant concerns about the removal in the Draft Legislation of the obligation for there to be any contract in place at all between the "agency" as defined and the individual. Where it is intended to impose direct statutory obligations to deduct at source and to report to HMRC on all individuals, it becomes practically impossible to comply where the obligation extends beyond people with whom the "agency" has any sort of contractual relationship, and in respect of which there is no particular reason why in the ordinary course of conducting business they are likely have such a relationship, or even to know of their existence.

(d) ELA queries whether the proposed definition at section 44(1) is assisted by the addition of the words “or is personally involved in the provision of", as this would appear to bring in scope individuals who are not actually providing the services themselves. ELA understands the purpose of removing the obligation to provide personal service, but in

the event that a decision was taken to proceed with the proposals, it would seem unnecessary to extend the category of individual beyond those people who actually personally provide the services to the client themselves.

(e) As a more general point, ELA considers that there may be merit in examining the extent to which the proposed policy objectives might better be achieved through placing responsibility and/or liability on the ultimate client in addition to (or in place of) agencies. Under the current proposals, from the client's perspective, there is no risk and, accordingly, there is no particular incentive on a client to engage an intermediary operating in a manner satisfactory to HMRC.

(f) ELA makes the observation that if there was some risk placed upon clients under the legislation, this may enhance the prospects for HMRC eradicating false self-employment and increasing tax revenues. A very large number of these clients are high profile, often PLC companies, who will necessarily take all issues of compliance and risk very seriously. The fact that the client has no liability under the legislation at present where it engages intermediaries who then engage in a false self-employment model, might be considered as contributing to the abuse which the Government wishes to stamp out.

(g) If the ultimate risk on false self-employment fell upon the client, this is likely to encourage those clients to engage in a much more vigorous vetting process of intermediaries, and to be much more interested in the terms upon which the individuals who provide services to it are engaged. This in turn may provide better prospects for those employment businesses and other intermediaries which are operating in a manner which is satisfactory to HMRC to survive and flourish (because they can have a role in educating their clients and can help their clients to manage their risk), whereas those businesses who are prepared to take a chance will not.

(h) If clients were subjected to some risk, and fell short of their obligations, this could have very significant adverse affects on, for example, reputation and tender prospects for future business.

(i) Even at the low paid end where it would appear the major problems exist, lots of the clients will be very sizeable businesses with a lot to lose if they do not engage with temporary labour in a compliant manner through their intermediaries.

(j) Alternatively, it may be that in practice employment businesses place some of the risk on clients through contractual mechanisms and thus incentivise compliant behaviour from the client. Whether this happens is likely to depend on a number of factors, including the relative bargaining power of the parties.

4. Will the Draft Legislation achieve the stated policy objectives?

4.1 **Question 3: Do you have any general comments on the legislation as drafted and if it will achieve the stated policy objectives? If so, please provide reasons.**

4.2 **Proposed Timing For Implementation**

(a) The Draft Legislation is currently intended to be implemented on 6 April 2014 but due to the late consultation, final legislation and final guidance will be issued at the beginning of March 2014 at the earliest.

(b) ELA's view is that the proposed timing is extremely challenging for clients, intermediaries and individuals. In particular, it would be very difficult for intermediaries affected by the Draft Legislation to:

- assess the financial impact of the Draft Legislation on their business models (including but not limited to PAYE, NIC, SSP, SMP/SAP/SPP, holiday pay, pensions, potential employment claims, AWR claims etc.) through the engagement of professional advisors or otherwise;
- consider and implement alternative business models with full consultation with individuals (e.g. if a contractor who has to date regularly engaged sole-traders, decides to only engage individuals through umbrella companies this transition will take time to implement);
- educate clients on increased costs arising from the Draft Legislation;
- educate individuals on the reasons why they are receiving lower take-home pay;
- determine whether PAYE and NIC deductions are being applied to individuals at the end of the chain where other intermediaries are involved;
- put processes in place to raise enquiries with all clients concerning the supervision, direction or control that they have or could have over any individuals assigned to them (e.g. an employment business which supplies 10,000 individuals a day would have to perform this assessment on all 10,000 individuals by 6 April 2014 and have processes in place to assess these by day 1 of each assignment going forward);
- analyse the results of all enquiries;
- put processes in place to make the appropriate deductions for PAYE and NIC and make the relevant deductions;
- train and employ new staff with respect to this analysis and the new processes;
- amend and re-negotiate contracts with clients;
- amend and re-negotiate contracts with other intermediaries;
- amend and re-negotiate contracts with individuals.

(c) As there will not be sufficient time to do all of the above, it is ELA's view that the majority of intermediaries attempting to comply by 6 April 2014 (save for reporting procedures which are delayed until October 2014) are likely to have significant financial issues for any/all of the following reasons:

- individuals leave site due to their reduction in net pay; and/or
- clients refuse to increase fees; and/or
- the intermediaries' margin is insufficient to keep business running as normal.

(d) The likely result would be that in many cases, individuals will be left either out of work or some pay.

(e) Intermediaries will continue their current practices irrespective of the implementation of the Draft Legislation until they are able to do all of the above, by which time they may have incurred substantial liabilities, which may also lead to such intermediaries becoming bankrupt and leaving individuals without pay.

(f) In conclusion, if the Draft Legislation is implemented on 6 April 2014 it is our concern that the Government may fail to meet policy objectives because intermediaries may face significant financial issues and subsequently workers may be out of work.

(g) ELA agrees with the Government's decision to delay the reporting procedures until October 2014, which would give businesses 7 months to make the necessary amendments. ELA suggests that, as a minimum, the entirety of the Draft Legislation be implemented no earlier than October 2014 but suggests that the impact on businesses and individuals would be reduced if the legislation implementation date were to be moved to 2015.

4.3 **Interaction between the Draft Legislation and the Agency Workers Regulations 2010 ("AWR")**

(a) The changes proposed by HMRC will not impact upon an individual's right to bring an AWR claim. Currently, even if an individual is working through an intermediary/intermediaries but is supervised and directed by the client, they may be entitled to bring a claim under the AWR.

(b) We note, however, that it is possible that under the Draft Legislation an individual is "supervised" or "directed" and so is caught, yet he may not have rights under the AWR because he needs to be "supervised and directed".

(c) However, the implementation of the Draft Legislation is also likely to have a practical impact. Previously, those working through PSCs were unlikely to bring a claim in an Employment Tribunal claiming that they were "supervised and directed" by the client. This is because such individuals would benefit from an advantageous tax / NID position by being treated as self-employed by HMRC which would be undermined if they unpicked the self-employment relationship. If the Draft Legislation is implemented and PAYE & NIC is deducted because the individual satisfies that very wide test, then the benefit of self-employment disappears. We are therefore likely to see more AWR claims being brought by individuals even where engaged via a PSC. We note that this does not automatically mean their AWR claim will succeed as the test is much narrower under the AWR.

4.4 **Will the Draft Legislation achieve the stated policy objectives?**

(a) From the Consultation Document, ELA understands that these proposals have the following policy objectives:

- To prevent companies and employment businesses from using employment intermediaries to disguise the employment of their workers as self-employment in order to avoid paying employer's NIC and deny individuals employment rights (Policy Objective One); and

- To ensure that individuals who are not truly self-employed benefit from employment law protections such as national minimum wage, statutory sick pay, statutory maternity pay, statutory redundancy pay and pensions contributions under the auto-enrolment regime (Policy Objective Two).

Policy Objective One

4.5 ELA understands the Government's aim is to ensure that where someone is acting in the capacity of an "employee" from an Employment Tribunal's perspective, there should be legislation in place to prevent contrived arrangements being put in place to avoid this so as to ensure the right amount of tax and National Insurance is paid and to ensure an individual obtains the relevant employment rights.

4.6 **Efficacy of introduction of new test**

(a) The main change made by the Draft Legislation amends the test for 'employed' or 'self-employed'. Where individuals must "*personally provide their services or being personally involved in the service that is being supplied"* and are subject to control, direction or supervision by any person, they will be employees or workers. Where there is a lack of control, direction or supervision, they will be self-employed.

(b) The Consultation Document notes that the reason that the original definition of employment, which required personal service, is viewed as unsatisfactory is because contracts were drafted to state that personal service was not required and that a substitute could be sent instead. By using substitution clauses, employment businesses were seeking to give the impression of a self-employment model even where, in reality, the client would not have found a substitute to be acceptable.

(c) It is possible that, in a similar manner, employment businesses will now include provisions in contracts to the effect that the individual can complete the work within his own time and will not be under any supervision, direction or control. It may therefore remain difficult to determine whether an individual is properly considered to be self-employed (although the difference now would be the presumption that the individual was *not* self-employed).

4.7 **Width**

(a) In its current form, the Draft Legislation catches genuinely self-employed individuals, whether these are sole-traders or those working through personal service companies ("**PSCs**"), which we do not understand to be the Government's intention.

(b) There are no definitions as to what the words "supervision", "direction" or "control" mean and the requirement that only one of these terms apply according to the Draft Legislation (albeit the Consultation Document refers to "and") means it can cover a whole range of scenarios. Anyone could be "directed" to a certain extent, even the genuinely self-employed. For example, a decorator is directed to attend the residence between 9am and 5pm Monday to Wednesday to paint certain walls white and certain walls pink – is this sufficient to amount to direction? The lack of definition leaves the Draft Legislation both ambiguous, open to interpretation but, most of all, too wide in the scope of individuals who could potentially be captured.

(c) It appears supervision, direction or control can be exercised by any person in the chain – it need not just be by the client. Further, who exactly is the client also remains unclear. The definition in section 44(1)(a) is that it is a person to whom services are

provided; in a model where numerous employment businesses are engaged, the definition of 'client' would seem so wide that it could potentially apply to any employment business within the chain who both contract for and receive services. The definition of client would benefit from greater specificity, potentially by reference to the person who determines what the service will be and the scope of that service.

(d) While ELA acknowledges that the existing agency legislation had some of the issues in identifying the client, the test in the Draft Legislation will have a much wider application; in particular because it removes the need for a direct contractual relationship between the individual and the party responsible for deducting PAYE / NICs.

(e) The definition of 'supervision, direction or control' is overly wide and would apply to a much wider range of working relationships than the current IR35 test or the employment status test used by the Employment Tribunals.

4.8 **Practicality**

(a) The Draft Legislation puts the obligation to deduct PAYE and NIC on an intermediary that may have no involvement in the relationship between the client and the individual whatsoever.

(b) For example, an employment business places an IT contractor with a client for 3 months. Whilst the employment business is responsible for the original placement it is not involved in the day to day work of the IT contractor which could potentially evolve over the 3 month period (with varying degrees of supervision, direction or control). The legislation does not recognise the difficulties that the intermediary may face in determining whether there is supervision, direction or control or the fact that the quality, quantity and timing of that information will be determined by the client. As the client has no potential liability under the Draft Legislation, there is no legislative incentive on them to get it right. While this can potentially be dealt with contractually, the extent to which the agency is able to place obligations upon the client is likely to depend on the parties' relative bargaining power.

(c) Where an individual works on a variety of assignments in a day/week for a variety of clients, it would be extremely difficult for an employment business to assess whether the various clients have any supervision, direction or control of the individual during each and every assignment. Even if the employment business is able to determine this according to the current proposal, it would then need to operate PAYE and NIC with respect to some assignments but not others due to the variations in the levels of supervision, direction or control, which would be administratively cumbersome.

(d) There is often a long chain of supply and the Draft Legislation is unclear which entity in the chain will be responsible for the PAYE and NIC deduction. It would seem sensible for this to be the party with the direct relationship with the client, as they would have the best access to information about the supervision, direction and control exercised by the client. However, the Draft Legislation is not drafted in this manner and any party in the chain could potentially be liable for PAYE / NICs (given the uncertainty in relation to the identity of the "client" highlighted above in paragraph 4.7).

(e) Depending on which party in the chain is intended to be liable for paying PAYE / NICs, further clarity would be beneficial relating to what requirement there will be on the party making the deduction to inform other parties in the chain that it has done so. Further clarity would also be useful on any information sharing requirements; for example, whether the client is required to provide information to the employment business to

enable them to assess whether the requirements of section 44 of the Draft Legislation have been fulfilled.

(f) If the intermediary at the top of the chain is responsible for deducting PAYE and NIC, it will need transparency from the other intermediaries in the chain to determine the actual pay that the individual receives in order to ensure it is deducting the appropriate amount of PAYE and NIC. The other intermediaries may be unwilling to provide this information for commercial reasons as their margins will then be transparent. What should the intermediary responsible under the Draft Legislation do in this scenario?

(g) Further liabilities may arise in addition to the obligation to deduct PAYE and NICs. The employment risk is more likely to lie with the client, the responsibility for pension auto-enrolment, holiday pay and AWR is likely to lie with the intermediary that engages the individual directly and the entity with responsibility for SSP and SMP/SPP/SAP is unclear. This will cause confusion for individuals and businesses particularly in complex models/structures.

(h) It would seem to be a sensible proposition that the liability to deduct PAYE / NICs falls on either the employment business that contracts directly with the client (as they will be in the easiest position to determine whether supervision, direction or control is exercised) or the employment business which contracts directly with the individual (as they will have certainty over the individual's identity). However, if this were the case, the definition of the "agency" would need to be narrowed.

(i) The presumption that individuals will be deemed to be employed would require 'employment businesses' (NB not intermediaries) to record and/or report to HMRC certain information in respect of workers for whom they are not deducting 'income tax', including names and addresses of the clients and reasons for non deduction of PAYE.

(j) The information is similar to the quarterly reporting requirements for off-shore intermediaries (although these proposals are not finalised). The Government indicates that as there is already a legal requirement for much of the information to be kept by employment businesses, this means there is little extra impact on the administrative burden as a result of the reporting requirements. However, while some of the information listed at paragraph 6.6 of the Consultation Document clearly would be kept by the employment business, this is not the case in respect of the "*Reason why income tax and NICs has not been deducted by the employment intermediary*". This information is sophisticated and employment businesses will have to provide sufficient information to support their decision that the individual is properly treated as self-employed and that tax / NICs should not be deducted. Presumably this is the section which HMRC will focus on when determining whether or not the definitions have been properly applied. Putting together this information in respect of each person engaged by an employment business will be particularly burdensome.

4.9 **Breadth and clarity of definitions**

(a) As set out in paragraphs 4.6 and **Error! Reference source not found.** above, it can be unclear who the client is and whether or not the Draft Legislation is intended to apply to a variety of scenarios. For example, consider a scenario where:

- A customer orders furniture from an internet company and requires it to be delivered on Monday between 9am and midday at a specific address.

- The internet company engages a delivery company to deliver the goods between the time specified by the customer, 9am and midday on Monday, to the customer's address.

- The delivery company engages a contractor that supplies delivery drivers and vehicles to deliver the goods between the customer's specified time, 9am and midday on Monday, to the customer's address.

- The contractor engages with an individual who is a sole-trader (who works for a variety of contractors) and who has his own van and delivers the goods between 9am and midday on a Monday to the customer at their specified address.

(b) In this scenario, when considering the Draft Legislation:

- S.44(1) is satisfied; and

- S.44(2) is arguably satisfied because the definition is so wide; by providing the details of the address and the timing of the pick up and drop off, the individual is being directed by a person (even though the individual would normally be considered to be genuinely self-employed);

(c) What is unclear in this scenario is which intermediary is caught by section 44(3) of the Draft Legislation. Section 44(3) provides that where sections 44(1) and (2) are satisfied, the employee is to be treated for income tax purposes as being employed by the agency. An agency is defined in section 44(1)(b) rather ambiguously as "a third person" who contracts with the client. Is that the internet company or the delivery company? The key question then, is who is the client?

(d) Is it the internet company, which directs the delivery company as to when it wants the product delivered? If so, the delivery company would be responsible under the Draft Legislation.

(e) Alternatively, is it the customer who is the client as the original direction came from them, in which case the internet company is responsible under the Draft Legislation? (We note that there has been some limited first tier tribunal guidance (*Talentcore Ltd t/a Team Spirits v HMRC* [2010] UKFTT 148 (TC)) on the determination of this issue, which highlights the potential uncertainty.)

(f) What if the customer is actually a furniture shop and it is a shop customer that asked the furniture shop for the delivery at that time? The chain could be never ending. This creates uncertainty which needs to be addressed, both in the Draft Legislation but also in supporting guidance.

(g) Further, as set out above the reference to employment businesses and intermediaries is muddled. There is no definition of employment intermediary apart from in the glossary which appears to relate to the Consultation Document rather than any legislation. Nor does it reflect the use of intermediaries as set out in the Consultation Document which the Government is trying to address.

4.10 **Practical Impacts**

(a) It is ELA's view that if the Draft Legislation is implemented in its current form, it will have the following practical impacts:

- A move by individuals and clients away from using an employment business or a PSC to being employed directly by the client. Clients may want to move away from this model on the basis of increased costs; if the employment business has to deduct increased levels of NICs, they are bound to pass this cost on to the client. Clients will then need to decide whether they wish to engage the individual directly to save costs. While some clients may not want the direct relationship with the individual, others may consider this worthwhile to save costs.

- Individuals will benefit from direct engagement by the client because where the Draft Legislation applies, the worker will find themselves in the peculiar position of receiving less pay due to PAYE and NIC deductions, yet not being able to benefit from employment protection such as unfair dismissal in the Employment Tribunal because of the status of current case law.

- A significant surge in Employment Tribunal claims being brought by individuals against employment businesses, contractors and clients. Where the Draft Legislation applies, individuals are more likely to consider themselves as having employment rights as they are being taxed and subject to NIC in the same way as employees. This would result in a waste of Tribunal resources where individuals bring weak claims because they do not understand the differences between the HMRC tests and the employment status tests in the Employment Tribunal.

Policy Objective Two

4.11 Sections 7.1, 7.4 and 7.8 of the Consultation Document suggest that the Draft Legislation would mean that more individuals will have the employment status of an employee (for the purposes of the Employment Tribunals too) by virtue of the agency being caught by the Draft Legislation. This would in turn contribute towards the policy aim of ensuring that many more people enjoy the benefits of statutory employment protections. It is ELA's view that this argument has little value as the individual legislation uses different tests to determine an individual's entitlement than that set out in the Draft Legislation to determine whether PAYE / NIC should have been deducted. We have considered the individual legislation in paragraphs 4.13 - 4.17 below.

4.12 **Employment Status**

Scenario A

The individual is supplied through his PSC to the employment business and on to the client and the client exercises supervision, direction or control over the individual.

(a) The Draft Legislation therefore applies and the employment business, which contracts with the client, must deduct PAYE and NIC. before passing the funds to the PSC.

(b) According to the Consultation Document, the employment business supplying the individual, who works through his PSC, will be the "employer" of the individual even though the employment business does not exercise any supervision, direction or control over the individual. It is ELA's view that no Employment Tribunal would take this view. Instead, according to the status of current case law, the Employment Tribunal would be very unlikely to impose an employment relationship of any sort in this arrangement.

Scenario B

The individual is engaged as a sole-trader by a taxi company to collect and drop off people from a variety of client's businesses and residences. The sole-trader works through 5 taxi companies, he can refuse jobs and he works with a variety of clients. For one particular regular client, the arrangement through one of the taxi companies is that the client will contact the sole-trader directly once a week to take him to and from his residence to a meeting and the client directs the driver to take the scenic route. Therefore, the client exercises some direction over the sole-trader (i.e. it tells the individual where and when to pick him up from and to take the scenic route). However, if the individual isn't available one day, the client will contact the taxi company and the taxi company will send a replacement.

(c) The Draft Legislation therefore applies because the client directs the individual and as the taxi company contracts with the client, the taxi company must make PAYE and NIC deductions with respect to this particular job before passing any funds to the sole-trader.

(d) According to the Consultation Document, the taxi company supplying the sole-trader, will be the "employer" of the individual (and hence the individual will benefit from various employment rights) with respect to this one client because of the client's "direction" of the individual. The client does not otherwise exercise any supervision, direction or control over the individual. It is ELA's view that an Employment Tribunal would not take the view that the taxi company is the individual's "employer" in this scenario because there is no control, mutuality of obligation or supervision between the taxi company and the individual or between the client and the individual.

(e) In determining whether or not an individual is an employee of any entity, the Employment Tribunal will consider whether there is mutuality of obligation, control and personal service, together with other relevant factors.

(f) The employment test for the purposes of the Employment Tribunals is narrower than the test in the Draft Legislation which requires supervision, direction or control. Therefore, just because an individual satisfies the provisions of the Draft Legislation does not indicate that they will satisfy the Employment Tribunal's test for employment.

(g) By following those tests, even if the Draft Legislation applies, the individual's stronger argument in both scenarios would be that he is an employee of the client rather than the intermediary. However, in both cases it would be unlikely for such a claim to succeed.

(h) In particular in scenario A, in light of the cases of ***Smith v Carillion (2014)*** of ***James v London Borough of Greenwich (2008)*** and ***Tilson v Alstrom Transport (2010)***, it is very unlikely such a claim would succeed. The Court of Appeal emphasised in Smith and again in James that the key issue is whether it is necessary to imply a contract between an agency worker and a client in order to explain the worker's provision of work to the client, or his payment via the agency. If the arrangements in the agency documentation are genuine and implemented accurately, then it will be a rare case where it is necessary to imply a contract of employment. The Court also said "*it will be an exceptional case where a contract of employment can be spelt out in the relationship between the agency and worker*".

(i) It is ELA's view, therefore, that the Draft Legislation will not assist an agency worker's claim that he is an employee of either an employment business or a client.

4.13 **National Minimum Wage**

(a) The Consultation Document states in Section 7.2 that "*the intermediary will need to ensure that the worker is paid at least National Minimum Wage (NMW)*".

(b) All workers and agency workers are entitled to be paid NMW by the entity that pays them provided they are not genuinely self-employed ("*the individual undertakes to do or perform personally any work or services for another party to the contract whose status is by virtue of the contract that of a client or customer of any profession or business undertaking carried on by the individual*").

(c) The test for self-employment under the Draft Legislation is wider than that under NMW legislation. Having different tests will create uncertainty and additional complexity for both individuals and those engaging them, as historically there has been one single test for both tax and employment status purposes.

Scenario A

(d) The Draft Legislation will apply to the employment business but it is ELA's view that it will still be the PSC that is responsible for paying the individual NMW (provided he does not satisfy the client/customer test in which case he has no such entitlement to NMW).

Scenario B

(e) The Draft Legislation will apply to the taxi company and it is ELA's view that no entity would be responsible for paying NMW to the individual because the individual would satisfy the client/customer test.

(f) In conclusion, ELA disagrees that it will always be the responsibility of the intermediary that is responsible for PAYE and NIC deductions according to the Draft Legislation to ensure the individual is paid NMW.

4.14 **Statutory Sick Pay**

(a) An individual will be entitled to statutory sick pay if he is a "qualifying employee" whose earnings are liable for class 1 NICs.

Scenario A

(b) Ordinarily, when an individual works through a PSC, they will be entitled to claim SSP from the PSC. However, the position becomes unclear where an employment business makes the PAYE and NIC deductions, but the individual continues to work through a PSC. ELA considers that this matter requires further clarification in both the primary legislation and guidance.

Scenario B

(c) It is ELA's view that the taxi driver, if he met the qualifying conditions (which is unlikely here), would be entitled to SSP from the taxi company if caught by the Draft Legislation.

(d) Therefore, ELA agrees in part with the comment in Section 7.7 of the Consultation Document that "*by a worker and their employer paying Class 1 NICs (provided the worker meets the relevant qualifying conditions concerning earnings etc.), the worker gains entitlement to certain state benefits including Statutory Sick Pay*". However, this entitlement will depend on the circumstances.

4.15 **Statutory Maternity/Paternity/Adoption Pay**

(a) If the Draft Legislation applies, the individual will be an “employed earner” for NIC purposes and so should be entitled to statutory maternity, paternity or adoption pay provided he satisfies the eligibility requirements. However, it is not clear to ELA which entity should pay the individual the SMP, SAP or SPP.

Scenario A

(b) The individual would be an "employed earner" of the employment business despite being engaged through his PSC. Therefore, ELA's assumption is that the individual could claim SMP/SPP/SAP from the employment business. ELA considers that further clarification is required in both the primary legislation and guidance.

Scenario B

(c) The individual would be entitled to SMP/SAP/SPP from the taxi company if caught by the Draft Legislation provided he met the eligibility requirements (which is unlikely here).

(d) Therefore, it appears that an individual who was previously a sole-trader or working through a PSC may be more likely to be eligible for SMP/SAP/SPP in light of the Draft Legislation. However, further clarification is needed in both the primary legislation and guidance on the entity responsible for such payments where the individual continues to be supplied by his PSC.

4.16 **Statutory Redundancy Pay**

(a) "Workers" are generally not entitled to statutory redundancy payments unless they fall into a specific category of roles, e.g. clerks of the peace, justice clerks, certain chief fire officers, etc.

Scenario A and B

(b) Agency workers supplied by employment businesses to clients are not entitled to statutory redundancy payments unless:

- they are already employed by the employment business; or
- they can successfully argue that they fall into the rare circumstances in which an Employment Tribunal will regard them as employed by the agency or the client (see paragraph 4.12 above regarding status of current case law); and
- they can satisfy the 2 years’ continuous service requirement.

(c) Therefore, although statutory redundancy pay is referred to in section 1.6 of the Consultation Document as an entitlement the worker may be eligible for as a result of this Draft Legislation, ELA’s view is that even if the Draft Legislation is implemented in its current form, this will not automatically mean that a worker is entitled to a redundancy payment.

4.17 **Pensions Auto-Enrolment**

(a) Section 7.2 of the Consultation Document suggests that the entity responsible under the Draft Legislation for making PAYE and NIC deductions would also be responsible for making employer's contributions into pension schemes.

Scenario A

(b) Currently, if a worker is paid by his own PSC and the services he provides is as part of his own business, then there is no auto-enrolment obligation on any party.

(c) However, if the Draft Legislation applies (because the worker is directed, supervised or controlled) and so the employment business makes the PAYE and NIC deductions, will the employment business then be required to auto-enrol the worker too even though he is engaged by his PSC?

(d) From a pensions perspective, it would make logical and practical sense for the entity with the obligations to deduct PAYE and NIC. to auto-enrol the worker. However, if an employment business engages a PSC, then according to Regulation 89 of the Auto-Enrolment Legislation, the “relevant person” that should make deductions for auto-enrolment purposes is the entity “responsible for paying the agency worker in respect of the work”, which would be the PSC.

(e) Therefore, it is ELA's view that we end up with a scenario in which the employment business is responsible for PAYE & NIC deductions and the PSC is responsible for auto-enrolling the worker. This is confusing and an area which would benefit from clarification in the primary legislation and guidance

Scenario B

(f) The taxi company could potentially be responsible for auto-enrolling the worker on this occasion, but not if the Pensions Regulator was satisfied that he was providing services as part of his business.

(g) Therefore, ELA's view is that it will not always be the case that the entity responsible for making PAYE and NIC deduction will be responsible for auto-enrolling the worker and in some cases this responsibility will fall on an intermediary lower in the chain or not at all due to the different test applied by the Pensions Regulator when compared with the Draft Legislation.

4.18 **Other Considerations**

(a) Having strongly criticised companies for forcing workers to pay fees to employment intermediaries of up to £25 per week, the Draft Legislation does not contain any specific proposals that would prohibit or discourage agencies from charging such payments.

(b) Under section 6 of the Employment Agencies Act 1973, there is already a prohibition on employment agencies or employment businesses charging a fee to work seekers in exchange for finding them work. In many cases ELA therefore presumes that enforcement action could be taken if it appears there is a breach of the section 6 prohibition by an employment business. To the extent that there are agencies involved in supplying the services of workers which are not captured by this prohibition (which is unclear), consideration might be given to applying such a rule to all agencies which fall within the section 44 ITEPA definition.

5. Interaction with IR35

5.1 Question 4: Is the interaction with IR35 likely to cause any issues? If so, please state what they are likely to be.

5.2 Introduction

(a) The IR35 legislation (set out in Chapter 8, Part 2 ITEPA 2003) applies to PSCs. It "looks through" the contractual chain in circumstances in which "but for" the existence of the PSC the individual would be an employee of the client.

(b) The Draft Legislation amends the existing agency legislation (set out in Chapter 7, Part 2 ITEPA). The Draft Legislation will apply to all forms of intermediaries (referred to in the Draft Legislation as "agencies"). An agency for these purposes is any entity which interposes itself between a worker and the client including PSCs. The Draft Legislation "looks through" the contractual chain in a wider set of circumstances than IR35. As discussed above in more detail, under the Draft Legislation the individual will be treated as an employee of the agency if the individual has to personally provide services or be "*personally involved in a service that is being supplied*" unless it is shown that the worker is not subject to (or to the right of) supervision, direction or control by any person.

5.3 Consultation

(a) The Consultation Document seems to contain a number of contradictory statements on the interaction between the Draft Legislation and IR35 with the result that the policy aim in relation to this issue is unclear.

(b) For example, paragraph 4.6 of the Consultation Document states that the Draft Legislation is not intended to apply to PSCs differently to the manner it does now and that the interaction between, and the order in which, the agency legislation and IR35 will remain as it is currently. Paragraph 4.7 of the Consultation Document states "*Those working through PSCs will ... need to consider, as they do now, the agency legislation*." However, paragraph 4.8 of the Consultation Document states that Draft Legislation will not generally apply to PSCs as they will not meet all of the relevant conditions.

5.4 Relevant scenarios

(a) There are two main circumstances where we believe that the interaction of the Draft Legislation and IR35 needs to be considered. These are:

- Where the PSC contracts with the client directly; and
- Where the PSC contracts with an agency which, in turn, contracts with the client.

5.5 Interaction of the Draft Legislation and IR35 where the PSC contracts directly with the client

(a) There are two situations to consider as set out below.

(b) The first situation is where the individual supplying his services through his PSC is genuinely self-employed by reference to the case law employment status tests. In this

scenario the PSC falls outside IR35. It has traditionally been accepted that the PSC in this situation may legitimately pay the individual a mixture of salary (subject to PAYE and NICs) and dividends on the shares held by the individual. It should be noted that identifying whether an individual is genuinely self-employed by reference to the case law employment status tests is (as can be the nature of case law) a potentially unclear and conflicting exercise.

(c) In this situation the issue is whether the Draft Legislation applies and, if so, whether it creates an obligation on the PSC to operate PAYE and NICs on any dividends.

(d) Most individuals supplying their services through a PSC are supplying personal services. To fall outside the Draft Legislation the PSC must therefore be able to show that the individual is not subject to (or to the right of) supervision, direction or control as to the manner in which the duties are carried out. Contrary to the statement at paragraph 4.8 of the Consultation Document, we consider that in fact many genuinely self-employed workers supplying their services through a PSC will either be subject to the right of control, supervision or direction or will not be able to show that they are not subject to the right of control, supervision or direction and accordingly will be deemed to be an employee of the PSC for the purposes of the Draft Legislation regime (even though they would not be an employee of the PSC for IR35 purposes).

(e) Where the Draft Legislation applies the agency has an obligation to operate PAYE and NICs on all "remuneration" receivable by the individual from any person in consequence of providing the services unless that remuneration constitutes employment income of the individual under another provision in the tax legislation. "Remuneration" for these purposes excludes anything that would not have constituted employment income of the individual if it had been receivable in connection with an employment apart from under Draft Legislation.

(f) What constitutes "remuneration" in this context? Is it the amount the PSC receives from the client and/or the amount paid by the PSC to the individual? HMRC's supplementary guidance note suggests the latter (allowing amounts paid (for example towards running costs of the PSC) and employer NIC to be deducted). However we consider the use of the word "receivable" in the legislation is ambiguous and consideration should be given to changing it to "received".

(g) HMRC's supplementary guidance note confirms that dividends will be excluded from "remuneration" for the purposes of Draft Legislation provided that the dividends are paid as a genuine consequence of the individual's shareholding in the PSC. However, in "cases of avoidance" HMRC reserve the right to treat dividends as remuneration either under Draft Legislation or the general earnings provisions. To avoid unnecessary uncertainty HMRC should clarify the types of cases that they consider would constitute avoidance in both the primary legislation and the accompanying guidance.

(h) The second situation is where the individual supplies services through a PSC and IR35 applies. In other words, but for the existence of the PSC, the individual would be an employee of the client. Under IR35, regardless of whether the employee is paid in salary and/or dividends, the PSC is obliged to operate PAYE on a "deemed employment payment" which is computed at the end of the tax year with the tax payable by 19th April following the end of the tax year.

(i) In broad terms the deemed employment payment is calculated by reference to the amounts received by the PSC in the relevant year in respect of relevant engagements and the amounts received by the individual in that year in respect of relevant

engagements which are not chargeable to income tax but would be if the individual was employed by the client. Certain permitted expenses and allowances (including a 5% deduction for the running costs of the PSC, employer NIC, capital allowances and any amounts paid by the PSC to the individual which are chargeable to income tax) are deducted from this amount to arrive at the deemed employment payment.

(j) In this second situation, it is likely that the Draft Legislation will also apply since (as the worker, but for the existence of the PSC, would be an employee of the client) the PSC is unlikely to be able to show that the individual is not subject to the right of control, supervision or direction as to the manner in which the duties are carried out.

(k) As stated above, this will mean that the PSC will have an obligation to operate PAYE and NICs on all remuneration when paid unless it constituted employment income of the worker under another provision of the tax legislation.

5.6 **What amounts "constitute" employment income taxable under another provision in the tax legislation?**

(a) Any actual salary paid by the PSC will be excluded from Draft Legislation on the basis that it is employment income taxable under section 62 ITEPA.

(b) The position in relation to the "deemed employment payment" under the IR35 regime is less clear. The deemed employed payment is treated as employment income whereas the wording in the proposed section 44(1)(c) refers to amounts which "constitute" employment income which suggests the amounts must be actual (rather than deemed) employment income. This needs to be clarified.

(c) If the deemed employment income is excluded from the operation of PAYE and NIC under the Draft Legislation regime, how will this work in practice? The PSC does not calculate the deemed employment payment until the end of the tax year i.e. later than the obligations that will arise on the PSC under the Draft Legislation. This makes it impossible for the PSC to determine the amount (if any) of remuneration which should be subject to PAYE and NICs under the Draft Legislation.

(d) If the deemed employment income is not excluded from the operation of PAYE and NIC under the Draft Legislation, the PSC will be obliged to operate PAYE and NIC on all remuneration.

(e) This may result in more PAYE and NICs being payable under the Draft Legislation than under IR35 regime. It is not clear what (if any) policy objective this would achieve.

(f) We consider that it should be made clear in the Draft Legislation that the Draft Legislation does not apply in a situation where an individual is supplying their services through a PSC which contracts directly with the client, irrespective of whether IR35 itself applies to the PSC. If this is not made clear, then the Draft Legislation regime effectively undermines and/or outweighs IR35. It allows HMRC to impose IR35 in a much broader set of circumstances. It is generally unsatisfactory to treat an individual as an employee only because it is not possible to show that the individual is not subject to a right of supervision, direction or control.

5.7 **Interaction of Draft Legislation and IR35 where the PSC contracts with an agency and the Agency contracts directly with the client**

(a) Assuming that the Draft Legislation applies because the individual is obliged to provide personal service and it is not possible to show that the individual is not subject to the right of supervision, direction or control, there are two issues to consider.

(b) The first issue is whether the agency would have an obligation to operate PAYE and NICs under the Draft Legislation.

(c) Under the current agency legislation if an agency contracts with a PSC the Agency has no obligation to operate PAYE and NICs. This is because the current legislation requires there to be a contract between the agency and an individual. HMRC guidance in the Employment Status Manual confirms this position:

(d) ESM2004 states:

"*The agency legislation applies to contracts between third parties and individuals. It does not apply to contracts between third parties and companies. Where the contract the agency has is with a company, then the legislation will not operate to treat services rendered under that contract as being the duties of an office or employment*."

(e) ESM2017 states:

"*The agency legislation does not apply where the contract for the supply of services is between the agency and a company rather than between the agency and the worker (see ESM2004). A worker may form a 'one-man' service company and offer services via that company. The legislation will not apply to the contract between the agency and the service company in these circumstances provided the contract with the agency for the worker's services is genuinely made by the service company. The legislation is not avoided simply by including the company's name on a contract obviously meant for use by an individual or by arranging for payment to be made to the company.*"

(f) Where work is genuinely undertaken via a PSC, the individual will normally be chargeable on employment income, and liable for Class 1 NICs, on the remuneration from his or her office as a director or employee of that company.

(g) Whilst paragraph 4.5 of the Consultation Document indicates that Draft Legislation will only apply where the "*worker is not already an employee of another company*", the definition of an agency contract i.e. a contract between the worker and the agency, has been deleted. The position therefore needs to be clarified.

(h) We consider that the Draft Legislation will result in additional complexity if it obliges an agency that contracts with a PSC to deduct PAYE and NICs on the remuneration receivable by the individual which would not otherwise constitute employment income of the individual. As stated above it will be impossible for the agency to determine the amount (if any) of remuneration which should be subject to PAYE and NIC under the Draft Legislation, particularly if the deemed employment payment must be taken into account.

(i) Given the presumption under the Draft Legislation regime that an individual will be subject to (or to the right of) supervision, direction or control by any person and the requirement to obtain and keep relevant evidence to the contrary, many agencies providing the services of someone working for a PSC will simply subject the whole of

the fee payable to the PSC to PAYE and NICs rather than run the risk of failing in their PAYE/NICs obligations. This would mean that two companies have to account for PAYE and NICs on one contract and/or the individual has to reclaim PAYE deducted, which adds substantially to the administrative burden on businesses.

(j) If this is not the intention, then it should be made clear that Draft Legislation does not apply to an agency which contracts with a PSC, irrespective of whether IR35 applies to that PSC or that an additional mechanism should be applied to prevent the issue highlighted above. A clear definition of a PSC would be required in this case.

(k) The second issue to consider is whether the PSC itself will have any PAYE and NICs obligations under Draft Legislation if the agency contracts with the client.

(l) The answer to this question appears to be no since the individual will be treated as an employee of the agency rather than the PSC. The proposed changes to Section 688 ITEPA provide that where a person (other than the agency or client or an agent or an intermediary of the agency or client) makes a payment of or on account of PAYE income that person is treated as an intermediary of the agency. However, unless that intermediary operates PAYE, it is still the agency's obligation to operate PAYE.

(m) If the above analysis is correct, this appears to be the right conclusion from a policy perspective; the PSC should only be potentially subject to IR35. However, it reinforces the need that it is made clear that Draft Legislation does not apply to an agency which contracts with a PSC or a PSC which contracts directly with the client to ensure a level playing field.

5.8 **Conclusion**

The short term effect of Draft Legislation as currently drafted is to create enormous uncertainty for PSCs. In the medium to long term, if the current proposals are not amended the Draft Legislation regime will undermine IR35 and lead to onerous tax obligations. This is likely to mean that the use of PSCs will diminish over time, which in turn will impact upon the willingness of entrepreneurs to form their own businesses. This runs counter to Government policy to encourage entrepreneurs and help small businesses by cutting red tape.

6. Targeted Anti Avoidance Rules ("TAAR")

6.1 **Question 5: Would ensuring the intent of this legislation is maintained, such as with a TAAR, be helpful in preventing attempts to avoid this legislation?**

6.2 At present, as set out in this Response to Consultation, there are a number of outstanding issues and concerns as to how the Draft Legislation will work in practice.

6.3 In particular, as highlighted above, if the Draft Legislation is implemented in its current form, many employment businesses and individuals currently engaged on a self-employed basis will need to make significant changes to their working models to ensure that they are in compliance with the Draft Legislation; in particular with regards to the deduction of PAYE / NICs but also with the proposed reporting requirements. Such changes are likely to take some time to implement, particularly for large employment businesses who will need to make enquiries to determine whether a client (or another party in the chain) exercises supervision, direction or control over each individual currently engaged on a self-employment basis, and adjust their treatment accordingly.

6.4 There is no suggestion that genuine employment businesses or self-employed individuals will seek to avoid the requirements of the Draft Legislation and at this stage the implementation of a TAAR would appear to be premature.

6.5 Further, the introduction of a TAAR would be overly punitive at this stage, given that many employment businesses / individuals will struggle to correctly implement the new statutory requirements given the inherent complexities and the proposed timeframes and are therefore likely to fall foul of the Draft Legislation.

6.6 ELA suggests that once the Draft Legislation is implemented, HMRC allows some time for employment businesses to adjust to the new measures before determining whether there is avoidance to a scale that would warrant the implementation of a TAAR.

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