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HMRC Consultation: Off-Payroll Working in the public sector: reform of the intermediaries legislation

Response from the Employment Lawyers Association

18 August 2016

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Introduction

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 courts and employment tribunals. It is not ELA's role to comment on the political or policy merits or otherwise of proposed legislation or regulation, rather it is to make observations from a legal standpoint. Accordingly in this consultation we do not address such issues. ELA's Legislative and Policy Committee consists of experienced solicitors and barristers who meet regularly for a number of purposes including to consider and respond to proposed legislation and regulations.

The Legislative and Policy Committee of ELA set up a working party under the chairmanship of Stephen Ratcliffe of Baker & McKenzie LLP to respond to HMRC's consultation. Its response is set out below. A list of the members of the ELA working party is at the end of this paper.

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

We consider that the concepts outlined in these Acts are sufficiently easily understood.

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

None

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

This is ultimately a political decision, requiring as it does an analysis of the reasons why the existing proposals apply only to the public sector and not to the private sector.

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

None

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

In many cases, it may be impossible for an agency-engager to make an informed decision about the status of an engagement without information from those familiar with the commercial arrangements and the purpose of the engagement. As is recognised in the consultation paper, a number of agencies could be in the contractual chain between a PSC and an end-user. Often, the agency with the relationship with the end-user will prevent any other agencies in the chain from contacting the end-user directly. As a result, in many cases it will be very difficult in practice for the agency-engager to obtain the relevant information from the end-user in order to answer part 2 of the test and, hence, to determine whether or not tax and NICs should be deducted.

We would, therefore, suggest that rules are put in place to allow for this information flow for the agency-engager's purposes. One possible approach would be for those rules to take a similar approach to the rules regarding exchange of information in the Agency Workers Regulations 2010 ("**AWR**") so that:

- An end user will need to provide the agency (or relevant intermediary if more than one intermediary in the chain – see below) with the information that is required in order to undertake the analysis by completing the online tool.

- It will remain the agency-engager's responsibility to complete the on-line tool based on the information with which it is provided.

- If the agency-engager is found to have failed to deduct tax and National Insurance when it should have done, the default position is likely to be that liability rests with the agency-engager. However, if the agency-engager took reasonable steps to obtain relevant information and made its determination of whether tax and National Insurance should be deducted in good faith based on that information, the intermediary or end-user which was responsible for provision of inaccurate or misleading information would become liable for the tax and National Insurance. Liability would pass to intermediaries to the extent that the end-user provided information to the party it engages with and it is not passed promptly down the chain. It is therefore in the interests of all parties to exchange information in a timely manner.

Alternatively, in the event that the agency-engager does not have sufficient information to be able to complete the analysis, the obligation could be placed on the worker/personal serviced company to provide information to the agency-engager to allow it to do so. Arguably, this is a more straightforward approach, since the worker should be in a position to understand how his/her relationship with the end-user is intended to work in practice. However, if the worker is to be incentivised to provide accurate information by the threat of liability for unpaid tax / NICs falling on them, query whether this simply places HMRC in the same position of having to enforce against individuals personal services companies rather than the end-user or agency-engager.

Strict time limits would be needed regarding the provision of information both on commencement of an assignment, and if the assignment changes e.g. the end-user must provide information to the intermediary it engages at least 5 working days prior to the commencement of an assignment and within 10 working days of any change to the assignment which would change the nature of the engagement which would change the analysis of whether tax and National Insurance is applicable.

In the absence of rules as to the exchange of information, the parties would be relying on contractual provisions within each contract between the end-user and the first intermediary

and all subsequent intermediaries, which reflect the needs of the agency-engager at the bottom of the chain. The agency-engager has no direct control over these contractual clauses.

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

It is likely that this accounting would require a revision to public sector engagers' existing accounting software, which typically does not currently allow for such a deduction to be applied before tax and NICs is levied. In practice, this should be no more complex than allowing for salary sacrifice arrangements.

However, potentially far more complex is the form of accounting for VAT required in Example 6. In our experience, current accounting systems do not allow for this structure whereby VAT is separated from the taxable earnings and paid (presumably via payroll) separately from PAYE-able income. This is likely to require a material redesign of payroll systems, likely at significant cost.

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

None

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

Yes, provided that some of the questions are adapted and clarity is provided on the meaning of each question within the test, perhaps by way of explanatory guidance.

For example:

- *"Is the worker hired through an agency?"* To most end-users this will just be read as referring to traditional recruitment companies, not the "consultancies" or "outsourcing specialists" that the Consultation paper refers to on page 13. Some further explanation of what is meant by the word "agency" will therefore be required.

- *"Is 20% or more of the contract for materials consumed in the service?"* This question is likely to be very difficult for an end-user to answer. Will they always know at the beginning of an assignment how much of it will include materials? It seems likely to lead to some end-users or intermediaries stating in their contracts with the personal service company that 21% or more of its fee must be spent on materials.

- We would query why the *"20% materials"* factor is included at all, given that it seems to be more indicative of the price of materials used in the particular service, than whether the personal service company is working in a quasi-employment context. The workers caught by the test are likely to be consultancy services which are people-led, for example IT and accountancy services. If this is not the Government's intention, we suggest that the "20% materials" test is reconsidered.

- What is *"owns their own company"* intended to mean? Is this limited to companies in which the worker owns 100% of the shares and is the sole beneficial owner, or will partial ownership or beneficial ownership be covered? Query how an end-user will know what the ownership structure is? Page 5 of the Consultation paper states that it is relevant to a limited company (often known as a PSC) or any other intermediary as defined in Chapter 8 Part 2 ITEPA 2003. We suggest this explanation be provided so that end-

users do not class a partnership as falling outside of the test, when this could be included according to ITEPA.

- *"Are you an agency/third party/outsourcer/consultancy?"* We suggest this question (in diagram 3) be amended to include the reference to "employment business", which is used in the Conduct of Employment Businesses and Employment Agencies Regulations 2003 and which is very familiar to those working in the staffing supply sector. Otherwise, those "employment businesses" may genuinely believe they are out of scope when that is not the Government's intention.

- *"Third Party"* - We suggest that this reference to in diagram 3 be removed as it is so broad it is unclear to what it is intended to relate.

- Diagram 3 does not contain an agency which is supplying to another agency that is ultimately supplying to a public sector organisation. Therefore, the diagram suggests that an agency at the bottom of a long chain of agencies would be outside the scope of this legislation. We suggest that the second blue box in the diagram be amended so that it states *"Are you supplying a worker to a public sector organisation or to another intermediary which directly or indirectly supplies such worker to a public sector organization?"*

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

See our answer to question 8 above, which sets out our comments on diagrams 2 and 3.

We believe the questions in diagram 4 are too simplistic. They do not consider the necessary nuances of employment status case law or address what contracts may say versus the reality of the working arrangements. In addition, the current two-question test is much more simplistic than the HMRC's Employment Status Indicator tool. Indeed the current Employment Status Indicator tool will not give a status determination, without first calling HMRC for an opinion, if there is a contractual right to send a substitute but this does not reflect reality. We would recommend that the government should fully involve stakeholders in developing these tests and allow adequate time for the pilot and roll out. Furthermore, explanatory guidance should be provided. In particular, would a substitute clause in a contract between the agency-engager and the personal service company be sufficient or should it be made clear that this must be invoked in practice? Would an agency-engager know this?

Examples as to what may be classed as "control" would also be helpful in our view in a similar way to those provided in the explanatory guidance to the onshore intermediaries legislation. This is an extremely complex concept, informed by many years of case law, and reducing it to a subjective determination of what control means to the person completing the analysis will inevitably lead to dispute as to whether it has been correctly applied.

The flow-chart in the consultation regarding Christine's services is a case in point – in Box 2 HR's considerations are that she can't in practice send a substitute and there are some strong elements of control. These are much more nuanced considerations than simply answering yes or no to the two questions in diagram 4.

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

See our answers to questions 8 and 9 above about diagrams 2, 3 and 4.

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

An agency-engager at the bottom of a chain is unlikely to have certainty as they will need to consider the employment status of the individual (diagram 4) but they will not have the information in order to do so (unless the rules are implemented as suggested above).

Even if certainty can be provided on day one, it is apparent that a scenario could evolve/change as an assignment continues (e.g. although an end-user at the commencement of an assignment is happy for the worker to send a substitute, a few months into the assignment the end-user may refuse the worker's request so although originally out of scope, the worker becomes in-scope during an assignment). We suggest requiring the end-user to notify the intermediary of any changes to its information during an assignment, but this naturally gives rise to complexity in practice, since it requires the end-user to spot when a change has taken place which would or may impact the analysis.

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

See the rules referred to above at question 5.

If rules are not implemented, the agency-engager will be relying on other parties in the chain to ensure contractual liability for non-compliance passes. It would be preferable, we would submit, to ensure that the focus is on compliance, rather than the apportionment of risk for non-compliance.

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

We would suggest that guidance and examples are provided in each case, dealing with situation which are not clear-cut. This would ideally be backed up by trained advisers who could advise via a helpline in other cases which are not clear-cut.

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

Under the heading "Transfer of liability" (p.28) the consultation paper states in the preamble to the question, that *"Where HMRC identifies the rules have not been applied properly, **and** (emphasis added) inappropriate or inaccurate information has been used to make the determination, there are options for deciding where the liability should fall …."*

This would appear to be a two stage test to determine where liability should fall. Firstly, that the rules have not been applied properly and, secondly, that inappropriate or inaccurate information has been used to make the determination. We would submit that it would be preferable for the question of transfer of liability to be considered if either of those circumstances apply.

The options envisaged by HMRC for apportioning liability are:

- *Jointly and severally on the engager and the PSC.*

  If the engager has innocently made a determination about the application of the rules based upon *"inappropriate or inaccurate information"* provided by the personal services company and/or the worker then it is difficult to understand why, in those circumstances, the engager should face the burden of having to pay any outstanding tax and NI (as well as penalties and interest), whether jointly or at all. If an incorrect determination was made

by the engager in good faith, relying upon inaccurate or inappropriate information that it had been given by the personal service company and/or worker then it would seem that it would be fairer for liability to fall to the personal service company and/or worker for any outstanding tax and NI. See also our answer to question 5.

- *On the engager alone – if the engager makes a wrong decision.*

  If the engager has made an error in the determination as to whether tax and National Insurance should be deducted, then it seems equitable that the liability to pay the outstanding tax, NI, penalties and interest should rest with the engager unless the fault for that error lies with another party. However, if the engager's determination was wrong because it was based upon inaccurate information supplied by the personal service company then we would suggest that it would be fairer for liability to fall on the personal service company. See also our answer to question 5.

- *On the director of the PSC and/or the worker or the PSC itself where the PSC or worker fraudulently gives the agency or public sector engager incorrect information.*

  See our answer to question 15 on this point

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

Firstly, we note that there is a small but material difference between the language used in this question and in the bullet points immediately preceding it. The question suggests that the information need only be "*false*" before liability would transfer to the personal service company, whereas the preceding bullet points suggest that the information must be "*fraudulent*" before that would occur. The two standards are quite different: the latter requiring dishonesty and an intend to obtain some financial gain.

If the engager is required to prove dishonesty and intention, liability will rarely pass to the personal service company and the engager will potentially be penalised for the personal service company's failure to provide correct information. Query, however, whether liability should pass in the event of an innocent misstatement, such as where the personal service company truly believes that it will spend 20% of its fees on materials, but in the event manages to purchase those materials at a reduced rate. If liability is to transfer to the personal service company only in the event that false information is provided, further guidance will need to be given as to what constitutes false information whether some dishonesty or other intent is required. We would respectfully suggest that the alternative form of apportionment of liability suggested in our answer to question 5 would be easier to operate, since it requires only that the information the personal service company has provided is inaccurate.

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

We would anticipate that material investment will be required in adapting payroll systems to carry out the appropriate calculations. There will of course also have to be a degree of training for HR and payroll when the systems are first introduced.

The costs of undertaking the necessary analysis of whether tax and National Insurance is payable in respect of every engagement will also be material, and possibly off-putting to existing large-scale users of personal service company contractors unless those costs are in effect passed on to intermediaries or personal service companies themselves.

Depending upon the ultimate rules to determine which party is liable in the event of default, it is possible that material costs will arise (for HMRC, as well as the interested parties) in connection with challenges to HMRC's assessment of which party is liable.

ELA Working Party

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