

Off-payroll working rules from April 2020
Consultation Response
May 2019

Preface

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On behalf of the profession, we influence the legislative and regulatory environment in the public interest. At home we promote the profession and the vital role legal services play in our economy. Around the world we promote England and Wales as a global legal centre, open new markets for our members and defend human rights.

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Introduction

We refer to the HM Revenue & Customs document issued in February 2019 entitled "Off-payroll working rules from April 2020: Policy paper and consultation document" (the "**Consultation Document**") concerning the proposed extension of off-payroll tax rules to the private sector. These representations have been prepared by the Society's Tax Law Committee ("The Committee"). The Committee welcomes the opportunity to comment on the proposals contained in the Consultation Document.

Executive summary and general comments

In the Consultation, HMRC correctly identify the need to learn from the application of IR35 to the public sector before extending it to the private sector. Unfortunately, the proposals fall short of this aim – fundamental problems remain given the difficulties in determining employment status for tax purposes. By way of example, the National Audit Office's investigation in the context of the BBC's experience illustrates the problems.¹

Determining whether an individual should be regarded as employed for tax purposes is often complex. The correct determination will always depend upon the individual facts and circumstances, it is not unusual for there to be a risk of misclassification. These risks are increased under the current proposals given that contractual relationships may be indirect, with a series of contracts in any one supply chain. A client will not necessarily have all relevant information to hand, also the way in which services are supplied, or other relevant circumstances, may change over time.

An end user client, as well as an intermediate agency, risks liability for making the wrong determination, notwithstanding that appropriate review processes and procedures are adopted. If there is any doubt the tendency will be to make employment status determinations, which can only result in an increased number of disputes.

Whilst exclusions for small companies and equivalent "small" non-corporate clients are welcome, the proposals will benefit from additional specific exclusions. We suggest:

- that a person should not be liable for tax if appropriate procedures and systems are in place and are followed in relation to status determination; and
- ideally, it should be possible to obtain an advance ruling from HMRC that can be relied upon; or
- if a system of advance rulings is not possible then perhaps the on-line Check Employment Status for Tax (CEST) service could be used, although additional investment would be required to ensure that this tool is fit for the purpose; or
- a system of registration for gross payment for compliant taxpayers could be introduced. Both of the non-resident landlord scheme and construction industry scheme provide useful models.

As the proposals currently stand, we expect the new rules to be problematic in practice. If client and other persons are assessed to tax notwithstanding investment in appropriate procedures and systems then the whole tax system suffers from the resulting unfairness, arguments and reputation damage.

¹ <https://www.nao.org.uk/press-release/investigation-into-the-bbcs-engagement-with-personal-service-companies/>

Comments on specific questions in the Consultation Document

The numbering of the sections below corresponds to the numbering of questions in the Consultation Document.

- 1. Do you agree with taking a simplified approach for bringing non-corporate entities in to scope of the reform? If so, which of the two simplified options would be preferable? If not, are there alternative tests for non-corporates that the government should consider? Could either of the two simplified approaches bring in to scope entities which should otherwise be excluded from the reform? Is it likely to apply consistently to the full range of entities and structures operating in the private sector? Please explain your answer.**

We agree that the small enterprise definition could be adapted in the case of non-corporate entities. In view of the compliance burden, our preference would be for the reform to apply only where both the turnover and employees tests are satisfied.

- 2. Would a requirement for clients to provide a status determination directly to off-payroll workers they engage, as well as the party they contract with, give off-payroll workers sufficient certainty over their tax position and their obligations under the off-payroll reform? Please explain your answer.**

The issuing of status determinations to the worker and to the contracting party, to be passed down the contractual chain to the party which pays the Personal Service Company (PSC), should improve opportunities for over-cautious status determinations to be challenged. But the difficulty of making accurate determinations remains, as does the risk of secondary liability (irrespective of status determination).

- 3. Would a requirement on parties in the labour supply chain to pass on the client's determination (and reasons where provided) until it reaches the fee-payer give the fee-payer sufficient certainty over its tax position and its obligations under the off-payroll reform? Please explain your answer.**

Potentially yes, assuming that the status determination can be relied upon even if it is subsequently shown to be wrong.

- 4. What circumstances may result in a breakdown in the information being cascaded to the fee-payer? What circumstances might result in a party in the contractual chain making a payment for the off-payroll worker's services but prevent them from passing on a status determination?**

The greater the distance between the decision-maker and the facts, the more likely it is that misunderstandings occur. Also, the greater the number of parties the more likely the risk of mistakes or information failures moving up or down the supply chain.

- 5. What circumstances would benefit from a simplified information flow? Are there commercial reasons why a labour supply chain would have more than two entities between the worker's PSC and the client? Does the contact between the fee-payer and the client present any issues for those or other parties in the labour supply chain? Please explain your answer.**

Long supply chains may occur in a number of sectors; IT and finance are two examples where there is a culture of outsourcing/sub-contracting. This allows each

relevant party to do what they are best at. You may therefore have projects where certain elements of the agreed scope might be sub-contracted, perhaps multiple times. Also, projects may take years to deliver, with changes in the nature of what is contributed as well as changes in working relationships throughout the life of the project as it moves through different phases. All of this is problematic in the context of information flows as envisaged by the consultation.

- 6. How might the client be able to easily identify the fee-payer? Would that approach impose a significant burden on the client? If so, how might this burden be mitigated? Please explain your answer.**

In the case of long supply chains identification and classification are both problematic. Clients are contracting for services to be provided, they are not necessarily contracting with specific individuals. Unless the supply chain is short then identification itself may be difficult.

- 7. Are there any potential unintended consequences or impacts of placing a requirement for the worker's PSC to consider whether Chapter 8, Part 2 ITEPA 2003 should be applied to an engagement where they have not received a determination from a public sector or medium/large-sized client organisation taking such an approach? Please explain your answer.**

Presumably there is increased potential for conflict, arising because different people take different views of the same facts (indeed, different parties may have different understandings of the facts).

- 8. On average, how many parties are in a typical labour supply chain that you use or are a part of? What role do each of the parties in the chain fulfil? In which sectors do you typically operate? Are there specific types of roles or industries that you would typically require off-payroll workers for? If so, what are they?**

In the legal profession supply chains tend to be short, with clients engaging directly with a PSC or via a "platform" provider (i.e. agency).

- 9. The intention of this approach is to encourage agencies at the top of the supply chain to assure the compliance of other parties, further down the chain, through which they provide labour to clients. Does this approach achieve that result?**

As shown in Illustration B on page 15 of the Consultation Document, the client should pay fees gross to an agency in the contractual chain, even if it has determined that the worker would be an employee if employed by the client direct. Provided the client issues an appropriate status determination to the agent, the liability to account for PAYE and NICs transfers to the agent and potentially further along a chain of agents, halting when it reaches the party which contracts with the PSC. However, if the party liable to account for the tax defaults, the liability passes back along the chain so that the client and/or the first agent can become liable to account for these taxes, despite having paid fees gross and not retaining the funds to cover the tax. This appears to be a very harsh result, punishing parties which have complied with all of their obligations.

The consultation document suggests that parties will assure the compliance of those further down the chain but, short of retaining part of the fees pending receipt

of proof that the tax has been paid, it is difficult to see how this can be achieved with any certainty.

Where the client is uncertain about the status of the engagement, the position is even less clear.

If a paying party is faced with tax risk then that party will look to protect itself. Indemnities from the PSC and/or the worker are unlikely to be acceptable – disputes may take years to resolve and the financial position of the PSC and/or the worker can change significantly. Hence the reference above to deductions on account. But clearly this is not satisfactory where the worker is of the view that the correct status determination is not employed.

For some workers such conflicts may simply result in their leaving the workforce, where a traditional employer/employee relationship is not available in substitution on the same (net economic) terms.

- 10. Are there any potential unintended consequences or impacts of collecting the tax and NICs liability from the first agency in the chain in this way taking such an approach? Please explain your answer.**

We fail to see how any such first agency would accept the tax risks in question, without a deduction mechanism in place.

- 11. Would liability for any unpaid income tax and NICs due falling to the client (if it could not be recovered from the first agency in the chain), encourage clients to take steps to assure the compliance of other parties in the labour supply chain?**

Please see our comments above. We expect that the only commercial ways for a client to protect itself will be to: (i) deduct until such time as the position is known, or (ii) move to an employment basis subject to PAYE. Neither of these options will be attractive or commercially acceptable in practice.

- 12. Are there any potential unintended consequences or impacts of taking such an approach? Please explain your answer.**

The increased use of PSCs reflects changes in the marketplace, with greater variety and flexibility. New ways of working have been established, including in the legal market. We are concerned that this proposal represents a step backwards, making it more difficult for parties to work together. We predict that enactment of the proposals as drafted will reduce work participation, as some individuals (and would-be employers) are discouraged from working together.

- 13. Would a requirement for clients to provide the reasons for their status determination directly to the off-payroll worker and/or the fee-payer on request where those reasons do not form part of their determination impose a significant burden on the client? If so, how might this burden be mitigated? Please explain your answer.**

We do not consider it unreasonable for the client to be required to provide the reasons for its status determination directly to the worker and/or fee payer on request, assuming a reasonable period is allowed to prepare this. It is a necessary consequence of the client having the obligation to make a status determination

- 14. Is it desirable for a client-led process for resolving status disagreements to be put in place to allow off-payroll workers and fee-payers to challenge status determinations? Please explain your answer.**

It will be tempting for clients to err on the side of caution, as already apparent in the public sector (page 17 of the Consultative Document). A client-led status disagreement process is suggested in the document, but the fact that the client, worker and fee payer may ultimately agree on the status of the engagement does not necessarily mean that the same analysis will be accepted by HMRC. There needs to be a thorough overhaul of the Check Employment Status for Tax (CEST) service and guidance, well before the extension of the off-payroll working rules to the private sector. This should be supplemented by a facility to obtain rulings from HMRC in cases of uncertainty. The current CEST is too blunt a tool to deal with the different practical requirements of numerous sectors and ways of working.

- 15. Would setting up and administering such a process impose significant burdens on clients? Please explain and evidence your answer.**

It would be helpful to know what HMRC would be prepared to do to assist here. If there is a disagreement as to status then there needs to be a quick, accessible and independent route to resolve it.

- 16. Does the requirement on the client to provide the off-payroll worker with the determination, giving the off-payroll worker and fee-payer the right to request the reasons for that determination and to review that determination in light of any representations made by the off-payroll worker or the fee-payer, go far enough to incentivise clients to take reasonable care when making a status determination?**

The difficulty, as mentioned above, is that the determination of itself (correct or otherwise) does nothing to assist the client as to its secondary liability tax risk.

- 17. How likely is an off-payroll worker to make pension contributions through their fee-payer in this way? How likely is a fee-payer to offer an option to make pension contributions in this way? What administrative burdens might fee-payers face which would reduce the likelihood of them making contributions to the off-payroll worker's pension?**

We note that for higher-paid individuals the question of pension flexibility is less likely to be relevant, due to restrictions on contributions.

- 18. Are there any other issues that you believe the government needs to consider when implementing the reform? Please provide details.**

As explained in our responses above, we consider that the proposals place an unreasonable burden on the client (and agents) who can become liable to account for tax following the default of others. A client (or agent) which has complied with all its obligations could become subject to such a secondary liability even where a correct status determination has been made. There needs to be some mechanism to protect clients (and agents) acting in good faith. As mentioned above the choices may include a certification system analogous to that used in the construction industry allowing payment to be made gross to a party which carries a certificate authorising gross payment (with, crucially, no possibility of liability reverting to the payer in the unlikely event of default by a certificated party). Other safe harbours

might include a more extensive and reliable CEST tool coupled with a facility for HMRC to provide rulings in cases which cannot be determined by an improved CEST.

Because parties will be expected to adapt their behaviour in accordance with the proposed rules, the labour market will become less agile. The risk of non-compliance will make it harder to get people working quickly.

We are very conscious that tax disputes usually take many years to resolve. During this time the economic cost of default increases and, of course, workers' financial and other circumstances can and frequently do change. The current proposal shifts significant risks onto taxpayers. It does not deliver a balanced and appropriate approach and should be reconsidered.