LARSEN HOWIE
Ensuring Peace of Mind

Off-payroll working rules from April 2020
Response by Larsen Howie and Kingsbridge

Introduction

Larsen Howie, in conjunction with Kingsbridge, are pleased to respond to HMRC's consultation document *'Off-payroll working rules from April 2020'* which was published on 5th March 2019.

Both Larsen Howie and Kingsbridge are providers of business and tax insurances to contractors and freelancers as well as being specialists in IR35 and employment status generally.

Following responses to the consultation document *'Off-payroll working in the private sector'*, which ran from 18th May – 10th August 2018, the government announced at Budget 2018 its intention to extend the off-payroll rules, exclusive to the public sector, to the private sector with effect from 6th April 2020. Whilst it was apparent that this was always the government's preferred solution to tackling perceived "non-compliance", credit should be given to the government for delaying the reforms to April 2020 so as to afford businesses the time to understand and prepare for the changes.

The current consultation seeks to explore the best way to implement the off-payroll rules in the private sector, acknowledging that the private sector is different and more diverse than the public sector.

Defining the scope of the reform

Question 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 entities into the scope, 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?

We question the necessity to consider bringing non-corporate entities within the scope of the reform as it is difficult to envisage a business with annual turnover and balance sheet values in excess of £10.2M and £5.1M respectively not being incorporated either as a limited company or a limited liability partnership. Businesses with such inherent value will want the protection of limited liability rather than their owners being exposed to such material risk in the event of their businesses failing. Whilst it may be possible for a non-corporate organisation to employ more than 50 people in a given year, this seems unlikely as the House of Commons briefing paper No. 06152, 'Business Statistics', published on 12th December 2018, states that the vast majority of businesses, ie 96%, in the UK employ fewer than 10 people.

It would be highly unlikely that a medium or large-sized business would divest itself of its corporate wrapper simply to rid itself of obligations under the 'off-payroll' rules. As such, it should not be necessary to bring non-corporate organisations within the rules but to allay any concerns that HMRC may still have, we would recommend that the same criteria, as set out in s.382 Companies Act 2006, apply to **all** businesses regardless of their structure.

To impose separate criteria for different structures simply adds another layer of complexity and complication and might also have the unintended consequence of bringing certain non-corporate businesses within the scope of the legislation that had not been originally conceived.

Information requirements

Question 2: Would a requirement for clients to provide a status determination directly to 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?

It should be a fundamental right of the worker to know their employment status as deemed by the end client. Furthermore, the reasons behind each status decision should be required to be given to the worker rather than it simply be at the request of the worker. This will ensure that a proper audit trail can be followed, thereby also assisting HMRC in the event that they may seek to review status determinations.

This information will be a useful starting point where there is disagreement between the end client and worker over the workers' employment status. Whilst the worker may not agree with the determination at least they will be aware of the logic applied in reaching that decision and that will enable both parties to then enter into constructive discussions during the dispute resolution process that HMRC are also proposing.

Simply advising a worker whether or not they fall within the 'off-payroll' rules does not provide the full story and therefore does not provide a sufficient degree of certainty.

It is because the very nature of employment status is not a precise science, that absolute certainty cannot be achieved, particularly where there is an absence of the necessary expertise within the end client organisation. Even though HMRC seek to provide assurances by reference to CEST, results generated by the online tool still have to be tested by HMRC to ensure that the questions have been interpreted and answered correctly. Only then, would an end client and worker have the requisite certainty that the correct decision had been reached.

Question 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?

As it is the responsibility of the end client to determine the workers' employment status, then the fee-payer should be required to abide by that decision and not override it as some fee-payers have been rumoured to have been doing since 6th April 2017. Unscrupulous fee-payers create an unfair and unlevel playing field for their competitors to operate within and their discretion in status matters should be restricted.

HMRC's guidance, '*Off-payroll working in the public sector: reform of the intermediaries legislation – technical note',* states that the responsibility for deciding if the off-payroll rules apply lies with the public authority, agency or third party paying the contractor. Some agencies/fee-payers may view this as permission to ignore a determination by the engager. Where they choose to ignore an 'inside

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IR35' determination & not deduct the correct tax & NIC, whilst they will be leaving themselves at risk, if the end-user has taken reasonable care in their initial assessment and maintains that position throughout, both legislation and accompanying guidance should make it clear that the role of the fee-payer is to act upon the instruction of the end client in matters of status decision making.

Where the fee-payer is in possession of information that has a bearing on the status of the worker this can be divulged at the point the end client is assessing the workers' status or during the dispute resolution stage.

Making it clear to the fee-payer that their function is to act upon the instructions of the end client, those instructions being the actual determination, would therefore provide the fee-payer with certainty that they have met their obligations but not necessarily their tax position.

In the event that an 'outside of IR35' determination was successfully challenged by HMRC, the resultant PAYE and NIC liability should not rest with the fee-payer but rather the engager. It is iniquitous that the fee-payer should be penalised for simply following instructions. Legislation should therefore make it clear that the tax and NIC debt lies with the engager in such a scenario so as to provide certainty to the fee-payer that its tax obligations have been fulfilled once and for all.

Question 4: What circumstances might result in a breakdown in the information being cascaded to the fee-payer? What circumstances may 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?

In most cases, we would envisage the agency and fee-payer being one and the same organisation, making the communication of information a two-way process and therefore relatively straightforward.

There are other situations however, where recruiters in the supply chain are prevented from having contact with end clients, particularly where there is a Managed Service Provider (MSP) in the chain who contractually prohibits second-tier suppliers from contacting end clients.

In addition to contractual issues that prevent parties from passing on information there are also practical issues. Where there are complex supply chain models it may prove difficult for the right contact at each supplier to understand their responsibilities

The most obvious situation leading to non-communication would be a breakdown or fault in the lines of transmission of information. The relevant parties should therefore ensure that they put in place a robust and reliable system for the easy and effective flow of information, with integrated fail safes to ensure that any problems are rectified expeditiously. Alerts should also be a feature of such systems, to bring to the attention of when information is due and overdue. The latter would address the situation where the engager had overlooked to either carry out a status assessment or a party within the chain had not communicated a decision.

At the very outset of a contract, the identity of the fee-payer and its residency status should be made known to all parties in the labour supply chain. Should a different fee-payer be appointed at any time, then this should be brought to all parties attention immediately, so as to ensure the flow of information is not stalled. Perhaps the easiest and most efficient way to deal with this issue is to make it a requirement for the end client to provide the fee-payer with the determination directly.

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Question 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?

Given that the consultation proposes transferring the tax and NIC debt in situations where HMRC does not receive PAYE tax and NIC, it is therefore necessary for all parties to be in possession of information on a timely basis. Where the contractual chain is simply tripartite, and the agency and fee-payer are one and the same, then information sharing should not present any great difficulty. However, where there are multiple agencies involved, then to prevent any delays in the operation of the payroll function, it would be appropriate for the end client to directly communicate with the fee-payer.

Referring to our response at Q.4, if the fee-payer is made known to the end client at the outset of the contract then transfer of information directly should be straightforward. At the same time, all other relevant parties could be copied in so that everyone is made aware.

There are definitely situations where there are two or more entities interposed between the PSC and the end client. A typical recruitment scenario will involve the following parties:

End client → MSP → Fee-payer → PSC → Worker

There are also some situations where there is a further end-user client behind the end client. This therefore poses difficulties for the information to flow easily through the labour supply chain. Furthermore, there is also the issue of contractual prohibited contact between fee-payer and end client. Our suggested remedy to this problem has been set out in our response to Q.4.

Supply chains that involve multiple agencies are probably likely to occur where an end client deals with a preferred supplier who, in turn, then outsources the supply of workers to another employment business. This might involve more than one sub-agency, where there are multiple roles to be fulfilled which involve different disciplines and the sub-agency has a niche for sourcing workers of a particular skill.

Question 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?

Referring back to our response to Q.4, there should be a requirement at the outset of the contract for the fee-payer and its residency status to be make known to the end client. Failure for this information to be divulged within a set time period, e.g 10 working days, would then allow the end client to pass the responsibility on to the first agency in the chain until such time that the fee-payer's identity was revealed. This would relieve the end client of the burden of having to chase the agency(s) for the information.

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Question 7: Are there 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?

To make it clear to a PSC whether or not they themselves have to assess a workers' IR35 status, the end client should be required to acknowledge, in writing, to the contractor, whether or not they are a medium or large-sized business for the purposes of the 'off-payroll' rules. This should be done within, say 30 days. Failure to do so, would result in the PSC being able to safely assume that the 'off-payroll' rules are not applicable and that they should self-determine their IR35 risk.

In the event that they should have applied the 'off-payroll' rules yet failed to do so, then the end client or fee-payer would be held solely liable for any tax and NIC. This situation would remain in force until such time that the position was remedied.

In situations where an end client did not acknowledge to the worker whether or not they were a medium or large-sized business and found that they should have operated the 'off-payroll' rules, they may be tempted to simply build a case for that worker being self-employed to avoid having to pay tax and NIC retrospectively.

Question 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?

Generally, there are either four or five parties in the labour supply chain, viz:

End client → Agency/Fee-payer → PSC → Worker; or

End client → MSP → Fee-payer → PSC → Worker

We feel certain that HMRC already understand the role each party plays in the above chains.

Off-payroll workers are used in a variety of industries and for various reasons. Examples typically include I.T, engineering, oil and gas, where there is an absence of a particular expertise/discipline within an organisation or an existing workforce requires augmenting or supplementing.

Question 9: We expect that agencies at the top of the supply chain will assure the compliance of other parties, further down the labour supply chain, if they are ultimately liable for the tax loss to HMRC that arises as a result of non-compliance. Does this approach achieve that result?

This approach is one of the sins of the father being visited upon the son. Referring to our response to Q.3, if the fee-payer's obligations are made clear, ie to act upon the instruction of the client, nothing more and nothing less, then there should be no need for transfer of debt provisions.

An unscrupulous fee-payer could deceive an agency with false assurances that they are acting compliantly. If that agency has in place a system for monitoring compliance which the fee-payer successfully circumvents, then surely it cannot be equitable that the agency is punished for the wrongdoings of another party?

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Any punishment for non-compliance should sit with the non-compliant party and, if necessary, its directors/owners held severally liable to allow HMRC to recover any debts owing to the department.

If HMRC wish to pass responsibility for policing the obligations of the supply chain to the primary agency, then they should provide as much assistance as is possible to that agency. For example, if it were part of the PAYE reporting requirements to name the end client, primary agency and fee-payer, then HMRC would be in a position to inform the agency of any tax/NIC arrears as and when they arise, giving the agency an early opportunity to try to remedy the situation.

Primary agencies could require fee-payers to provide them with copies of Full Payment Submissions so as to ensure that the fee-payer was acting upon the instruction of the end client. However, this would only reveal that PAYE was being operated and would still need HMRC to bring to their attention any arrears of tax/NIC.

Question 10: Are there any unintended consequences or impacts of collecting the tax and NICs liability from the first agency in the chain in this way?

Presumably, any fees agreed between the parties will include the requisite tax and Class 1 NIC being passed down from the end client. If this is misappropriated by the fee-payer, then the primary agency could be left with significant debts that would have to be met from their own profits and reserves which, in turn, could potentially cripple that agency and put it out of business.

Question 11: Would liability for any unpaid income tax and NICs due falling to the engager (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?

Our response to Q.9 is equally applicable here.

Question 12: Are there any potential unintended consequences or impacts of taking such an approach?

Our response to Q.10 is equally applicable here.

If the end client has already passed down the requisite PAYE tax and Class 1 NIC as part of the fee arrangement, then it surely is not equitable to make that business pay twice for circumstances beyond their control, where they have already put in place satisfactory monitoring processes.

There is a risk that end clients would seek to impose onerous indemnities upon those in the supply chain, being far greater than the legal liability.

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Question 13: Would a requirement for clients to provide the reasons for their status determination directly to the off-payroll worker and/or 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?

Referring to our response to Q.2, it should be a fundamental right for the worker to be provided with not only the status determination but also the reasons behind that decision. However, any information that is not relevant to that decision making should be left to the discretion of the end client as to whether or not to bring it to the attention of the worker and/or fee-payer.

Whether an end client uses CEST, some other status tool , third party to arrive at status determinations, or deal with the process in-house, then those processes will only reveal the relevant information that helped form that opinion. The worker and/or fee-payer may well have supplementary questions following a determination but this will be a matter for the end client to decide at what point they wish to provide any further information, ie an informal discussion or during dispute resolution.

Question 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?

The lack of any formal appeal process has been a criticism of HMRC for a number of years now and the government's proposal that any status disputes should be dealt with 'in-house' suggests that HMRC do not have the resources or time to handle such disputes. Nevertheless, we welcome any suggestion to empower the worker to challenge a status decision where they fundamentally disagree with the opinion of the end client.

Given the current prevailing attitude of those HMRC officials involved with status work, which sadly falls short of the requisite level of impartiality one would expect, we welcome the proposal of a client-led resolution process. This is because we feel that end clients may be more prepared to listen to rational argument and give proper consideration to the relevance of facts and information, therefore arriving at a fair decision.

To prevent end clients simply dismissing a challenge to the determinations they make, the right to challenge should be enshrined in legislation. A time limit of, say 30 days, should be imposed upon the worker to mount any challenge and set in place the process of dispute resolution. Failure to do so would result in the end clients' decision becoming final.

There will need to be put in place safeguards to discourage frivolous challenges by workers. End clients may therefore wish to appoint independent arbiters such as the likes of Larsen Howie, who can properly assess the validity of any objection to a status determination. This would be similar to the Alternative Dispute Resolution (ADR) process that HMRC offer taxpayers but without the involvement of HMRC.

Question 15: Would setting up and administering such a process impose significant burdens on clients?

This will depend on the number of contractors an end client engages and how many of its decisions are challenged.

It cannot be ignored that businesses will suffer the burden of both monetary and time costs in implementing a dispute resolution process. How greater burden, however, will depend on the approach the end client takes and how sophisticated it wishes such a process to be. Again, outsourcing this function to IR35 experts such as ourselves, will reduce the time an end client has to spend resolving status issues thereby offsetting the financial cost it incurs in using third party arbiters, potentially making the cost burden neutral.

Question 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 of the fee-payer, go far enough to incentivise clients to take reasonable care when making a status determination?

This question cannot be properly answered until such time that HMRC define 'reasonable care'. For the time being therefore it is necessary to refer to the concepts contained within Sch. 24 FA 2007, the penalty regime for incorrect returns. Whilst there is no statutory definition of 'reasonable care', the measure for deciding on whether or not a person made a careless error in completing a return is:

a. an objective measure – a likeness to the long-standing concept in general law of negligence and
b. a subjective measure, dependent on the abilities & circumstances of each person.

In HMRC's guidance regarding reasonable care & tax returns, it states that it means doing everything you can to make sure the tax returns & other documents you send to HMRC are accurate.

The extent of 'reasonable care' may therefore vary according to the size of the end client organisation and the methods they employ for determining employment status. However, should their systems be robust and their decision making supported by sound reasoning, then this would be a sufficient demonstration of 'reasonable care' being exercised. Having to provide both the determination and reasons to the worker and fee-payer, is unnecessary for the purposes of 'reasonable care' alone but nonetheless should be a requirement for the reasons already previously stated.

Other matters

Question 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?

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Whilst the principle is well intentioned and welcomed, unfortunately we feel this may prove impracticable as the fee-payer's payroll system would have difficulty in capturing various and numerous different pension schemes.

Nevertheless, some effective mechanism needs to be explored to enable workers, disadvantaged by being treated as quasi employees, to obtain tax relief to personal pension contributions.

Question 18: Are there any other issues that you believe the government needs to consider when implementing the reform?

Clarification should be given to the situation where a worker's employment status is successfully re-classified by HMRC, ie from outside to inside IR35. If the end client/fee-payer took reasonable care in reaching a decision that a worker was genuinely self-employed but which was reversed due to technical arguments, then the fee-payer would be liable for the resultant tax and NIC. However, if HMRC were unsuccessful in recovering this from the fee-payer, would HMRC seek to use their powers under Reg. 72 Income Tax (PAYE) Regs. 2003 to collect the liability from the PSC even given the fact that the worker is not an employee but rather a quasi employee?

HMRC have signalled their intentions to improve their CEST tool which is to be welcomed. Nevertheless, if it is to be robust and reliable it must address all the tests of employment status and we are not certain that this is achievable. For example, the business on own account test may only be capable of being answered by the contractor as an end client or agency would not be privy to the information required to answer questions about this test. Furthermore, mutuality of obligation (MOO) is a fundamental test of employment, yet it does not feature whatsoever in the CEST tool because of HMRC's extremely narrow definition, ie the irreducible minimum. Failure to include this test by reference to a more sophisticated definition of MOO renders the tool incomplete. We note that HMRC are seeking to work with IR35 forum members and stakeholders to agree a version of MOO and also to consider how MOO can be included in CEST.

Decisions generated by CEST should better explain the rationale behind those decisions, giving commentary that will both educate the user and instil trust in the tool.

HMRC should make it clear that the CEST tool is not mandatory and that alternative employment status resources can be employed to help the user in reaching a decision.

It would be helpful if HMRC would indicate how frequently a contractor's employment status should be reassessed. This should be at the point there is a material change in contractual and/or working arrangements but HMRC should explain what they consider to be a 'material change'.

Clear guidance on Statement of Work (SOW) models is needed. When used properly and appropriately, we consider that these are a more measurable and effective means of obtaining services when compared to a standard time and materials model. However, we are concerned that SOW's will be used as a means of bypassing the 'off-payroll' rules, which could result in unforeseen tax and NIC arrears arising.

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