



Law Society
of Scotland

Consultation Response

Off-payroll working in the private sector

August 2018



Introduction

The Law Society of Scotland is the professional body for over 11,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland's solicitor profession.

We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom Governments, Parliaments, wider stakeholders and our membership.

Our Tax Law sub-committee welcomes the opportunity to consider and respond to the HMRC and HM Treasury consultation: Off-payroll working in the private sector¹. The sub-committee has the following comments to put forward for consideration.

General comments

We welcome the clarification that no Ministerial decision has been made at this stage. We welcome the fact that the Taylor Review team are engaged in this process and note that the intention is to develop a system that will work with any Taylor Review changes implemented in the future.

Our experience as practitioners highlights that the new public sector IR35 regime has impacted both private and public sector labour market in terms of flexibility and depth of the recruitment pool for project based engagements. In addition, we are aware that some public bodies have initially taken the decision to payroll all of the contractors they engage rather than analyse each engagement on a case by case basis. The result of this for some public bodies has been a shortage of choice to recruit from and contractors and agencies seeking to revisit costs and increase the rates substantially. In some cases, public bodies have encountered individuals withdrawing from potential projects.

The result is that some advisers have been finding that public bodies have been accounting for payroll taxes where none were, in fact, due which is not an effective or helpful situation for any government to find itself in as this ultimately increases the costs of delivering public sector outcomes and projects.

¹https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/708544/Off-payroll_working_in_the_private_sector_-_consultation_document.pdf

It should be recognised and accepted by government that this rule change has had more than a one-off tax cost of implementation. This has caused a real shift in responsibility and cost base where secondary Class 1 NICs are now payable.

Whilst it is acknowledged that there is an ongoing review of employment status, there remains a clear conflict between employment law and employment taxation. The former takes account of three statuses (employee, worker and self-employed) whilst tax and NICs take account of two – both of which are further complicated by IR35 legislation and the consideration of a hypothetical contract/deemed employment. This results in a highly confusing and complex situation for businesses and the public sector which is likely to be beyond the expected day-to-day knowledge and expertise of individuals within businesses who are left to make decisions in procurement, finance, HR and payroll departments. The result of the complexity is that rules are often followed incorrectly until picked up in an internal or external audit or enquiry or are simply ignored.

In general, it is our experience that public bodies have had to seek professional advice, train up staff and institute new policies for dealing with the new rules as well as face related increased costs affecting the costs of the services and projects they are tasked with delivering. This additional layer of bureaucracy on top of procurement regulation has caused difficulties in terms of operation as well as budget issues arising around the costing projects where additional NICs exposure might arise. The decision makers in businesses and organisations are rarely those who have to administer the payroll, HR or finance functions and there is a tension as to which role within a business should take responsibility for compliance with this as engagements of and for services are not something tax and finance will necessary be a party to.

Given the short passage of time since the introduction of the public sector rules, it is clear that there is insufficient evidence to assess whether the changes to the public sector have resulted in both improved compliance and correct compliance with the new regime.

Consultation questions

Q1. What could be done to improve the compliance enquiry process to reduce non-compliance, whilst safeguarding the rights of customers?

A specialist HMRC team should be engaged in this complex area and requests for information should be clear and direct, rather than piecemeal as part of an overall PAYE audit. Generic enquiries followed up by multiple requests for further information, as matters are escalated across HMRC, are both inefficient and unfair, particularly for those with a small tax, payroll, HR or finance function.

Extending the public sector rules to the private sector

Q2. Could the public sector regime better fit the needs of businesses? How?

An improved Check Employment Status for Tax (CEST) tool should be developed, with follow up guidance and a specialist dedicated helpline for scenarios that do not fit the criteria specified. CEST is presently very limited in scope and the answers are only as good as the information inputted. We are aware anecdotally that many professional advisers have used the tool on multiple occasions seeking answers for their clients and it is not just engagers who have been using the tool. On this basis, we would suggest that this puts into question any reliance on the output of the tool as an indicator of increased or greater compliance with the rules or of the bridging of the tax gap.

A clear and direct route to appeal any decision and also ensure that any penalty levied on customers is fair and proportionate would also be beneficial.

Q3. What if any, changes could help make the administration as simple as possible?

An employer toolkit that is clear and structured would be a useful start, a revised CEST tool with an additional option for scenarios or results that do not fit the current questions and less ability to manipulate results from this tool would assist those requiring to make decisions.

It would be preferable for engagers in the private sector not to become 'deemed employers' or be required to create a payroll to deduct PAYE and NICS from contractor payments. Whilst it is acknowledged that the consultation does not wish to create a new tax, it is suggested that some form of Construction Industry Scheme (CIS) style withholding could be imposed instead. If a CIS-style deduction is used, then it is the personal service company (PSC) which suffers the deduction and not the engager. It is clear that some businesses could run into serious cash flow difficulties if they are required to both deduct and pay PAYE and NICS where this was not required previously.

It is suggested that an addition to the Real Time Information payroll system could be developed asking employers about PSC engagement, for details to be provided as a form of record keeping and further developed to allow a withholding to be accounted for as part of the payroll system.

Q4. If the private sector rules were changed, do you have any evidence that there are parts of the private sector where the administration of any regime may need to vary even though the basic principles including for determining status, remain the same?

The application to SMEs may prove particularly problematic for businesses to adjust in time. It is suggested that a phased introduction akin to the introduction of auto-enrolment for pensions could be considered.

Businesses would need to seek advice on the implications of any changes. The imposition of an ongoing requirement on business to assess and account for payroll taxes requires detailed training, support and changes to administrative systems from HR policies to finance and tax protocols.

A more flexible and agile approach is likely to be required for the private sector as often the speed of engagement requires to be faster than in the public sector.

Third sector/charitable sector engagers may also face challenges in funding secondary NICs.

There is a clear power imbalance between contractors and business. SMEs may also struggle to impose contract changes and risk losing talent. Conversely, contractors may find that their contracts are amended by large businesses imposing their decisions regarding payroll on them with no right of appeal and little scope to challenge the contract changes or existing rates of engagement.

Start-ups and the tech sector may be hard hit, especially where individuals are providing services to several entities at the same time, some of which may be connected for tax purposes. For example, university spin-outs or where, for intellectual property and insolvency protection, several technology or IT based products are held separately.

Q5. Is there any evidence that parts of the private sector will not have, or be able to acquire the administrative capacity, knowledge and resources to enable them to implement any changes in relation to off-payroll workers?

SMEs and some third sector/charitable businesses are likely to face difficulties in resourcing compliance with a complex regime. As it stands, the increasing complexity of the tax system combined with onerous employer and corporate obligations mean that many businesses struggle to meet all of their obligations. Often these businesses are unable to afford to recruit the specialist knowledge they require.

Businesses, particularly SMEs, that seek to apply best practice and comply with any changes will face challenges that put them at a competitive disadvantage with any less-scrupulous businesses that may ignore changes until the stage that direct action is taken against them. This, in a sense, mirrors the impact seen in the public sector of difficulties in recruiting effectively in the context of the new system. There needs to be a fuller review of the relationship between tax treatment and employment status and rights, as acknowledged in the Taylor Review.

In addition, it would significantly assist a smoother transition to any new system if its implementation was delayed until April 2020 at the earliest. The experience from the public sector roll-out was that insufficient time was available to engage with software providers and advisers on the design of a compliant system for addressing the new regime. A delay would also have the added advantage of seeing a full cycle of the public sector application in operation – at present many of those from the contractor side will not have filed self-assessment returns in which claims for reimbursement etc may well have been made by a considerable number of them.

Q6. How could these difficulties be mitigated?

This is complex due to the diverse nature of the private sector and no simplistic one size fits all approach is likely to work.

Q7. What aspects of policy design might be adjusted if similar changes were brought in for the private sector? Should we bring in a specific penalty if agencies fail to comply?

Penalty and appeals require to be reviewed for both public sector and private sector rules.

In addition, there requires to be a clear method by which a deemed employer is able to recover overpaid employer NICs, where the PSC appeals against the IR35 decision and this is upheld.

Q8. What action should be taken in the case where the fee-payer hasn't acted upon the client's conclusion that the worker would have been regarded as an employee for income tax and NICs purposes if engaged directly? Should an obligation be placed upon the fee-payer to adopt the client's conclusion and there be sanctions for failing to do so?

The penalty regime requires to be considered and amended in line with any change in the rules. Proportionate and fair penalties should applied where appropriate for clear failings by an individual but there requires to be an appeal mechanism.

The power imbalance between engager and contractor should also be borne in mind when considering the imposition of any penalties.

Q9. What action should be taken if the worker or PSC is knowingly receiving income that has not had the right amount of tax and NICs deducted?

Appropriate sanctions could be built into the process. The burden of proof could be placed upon the PSC to demonstrate that they believed that they were paying the correct amounts of income tax and NICs, for example, on the basis of professional advice or advice from HMRC.

It is also worth noting that there are already sanctions available to HMRC to enforce against those deliberately ignoring their obligations and evading tax.

Q10. What systems and process changes would businesses need to make?

Each individual business would need to decide what was appropriate for them, with some assistance from their professional advisers. It is likely that IT solutions may need to be developed and policies developed across businesses. A 'one size fits all' package would not be suitable.

Where responsibility for ensuring that IR35 compliance is adhered to rests in each business will be case specific and depend on the industry, nature and frequency of engagement. This could be in one department or in several depending on the size and nature of the business. Procurement, HR, legal, finance, tax/payroll and other departments may all be involved.

Q11. Would there be any process and administrative cost implications for businesses? Can you provide evidence of the scale and nature of these?

All businesses would need to invest in support and training. Businesses would be required to acquire knowledge, IT/software/storage, professional advice, possibly recruit additional people, and this would be likely to be from the top down as the entire business would be affected.

Each business will deal with this differently depending on the sector and the nature of the business. Costs for some may be limited but for others substantial.

A major cost will be addressing the cash flow implications of meeting employer NICs and related costs of setting up any systems.

Q12. Can you provide any evidence that these costs would vary depending on how much notice businesses were provided for the introduction of any reform?

No.

Q13. Is there anything else HMRC could do to ease the implementation for businesses, and can you provide evidence of how this would ease implementation or administration for businesses?

Businesses need simplicity. A full and reliable employer's toolkit and an improved and reliable CEST tool are required. Training workshops, webinars, and instructive vlogs on the HMRC website would also be helpful. However, overall the burden on employers is going to be significant if these measures are brought in.

Encouraging or requiring businesses to secure their labour supply chains

Q14. Overall, what are your views on this option? Would it be a proportionate response to the issue?

The modern practices of working are moving towards a much more agile and flexible model. Regardless of what the tax obligations are or become, it is apparent that from a time and work life balance perspective that a more flexible approach to working is desired by many. Any model requires to acknowledge that flexibility and provide businesses with an ability to move quickly to secure the talent they require to deliver their projects and outcomes.

As suggested in our response to Q3, above, it would be preferable for engagers in the private sector not to become 'deemed employers' or be required to create a payroll to deduct PAYE and NICS from contractor payments, and some form of CIS-style withholding could be imposed instead. It is clear that some businesses could run into serious cash flow difficulties if they are required to both deduct and pay PAYE and NICS where this was not required previously.

Q15. If the government were to pursue this option, what checks should the client be required to perform?

Please see our response to Q14 above.

Q16. How should different views on employment status be dealt with? For example in the public sector, disputes should be resolved between the client and the worker, which ultimately allows either party to walk away if they do not agree.

We highlight the imbalance of power between engager and contractor as well as the inability of a contractor to walk away from a pay packet in some situations.

There is a risk both in the public and private sectors that the engager will find themselves on the wrong end of an employment tribunal claim which can incur significant cost for the engager. It is vital that engagers are given the opportunity and the tools and knowledge to make the right decisions about those they engage, whether through PSCs or otherwise.

Q17. How would HMRC best enforce compliance with securing labour supply chains, keeping in mind the need to mitigate or reduce dealing with each PSC individually?

Please see our response to Q14 above.

Q18. Should the requirement be underpinned by some form of penalty?

Please see our response to Q9 and Q14 above.

Q19. Should the requirement be underpinned by denying the client a deduction for the cost of labour from an unchecked supply chain?

Please see our response to Q14 above.

Q20. Should the requirement be underpinned by the risk that the client could be named as having used a non-compliant supply chain?

Please see our response to Q9 and 14 above. Naming and shaming is only proportionate where the correct checks and balances are in place in a system and where a system is clear and workable from the engager's perspective.

Q21. Would such penalties effectively change behaviour within labour supply chains, helping to ensure the correct income tax and NICs are paid?

Please see our response to Q9, Q14 and Q20 above.

Q22. What would the impact (including the effect on administrative burdens) of this option be on affected businesses, agencies, and individuals?

As we have suggested in our previous answers, any change is likely to cause administrative burdens and disrupt the market.

Q23. How effective would this option be in addressing non-compliance with the off-payroll working rules in the private sector?

Please see our general comments regarding lack of evidence of the effectiveness of the new rules for the public sector and our response to Q14 above.

Q24. Is there any way to improve this option which would make it more effective?

Please see our response to Q14 above.

Additional record keeping

Q25. Overall, what are your views on this option? Would it be a proportionate response to the issue?

We do not anticipate that this would be an effective or viable option.

Q26. If the government were to pursue this option, what information should be required to be gathered?

N/A

Q27. How could the government ensure that others in the labour supply chain pass accurate and timely information to the client?

N/A

Q28. What penalties should fall on the client or others in the labour supply chain if they fail to comply with the requirement?

N/A

Q29. What would the impact (including the effect on administrative burdens) of this option be on affected businesses, agencies, and workers?

N/A

Q30. How effective would this option be in addressing non-compliance with the off-payroll working rules in the private sector?

N/A

Q31. Is there any way to improve this option which would make it more effective?

N/A

Other options to consider

Q32. Are there other options, within the scope of this consultation as set out in Chapter 2, that would be effective ways of tackling non-compliance in the private sector that the government should consider (for example, possibly drawing on lessons from other countries)?

N/A

Q33. Would these, or any of the other options outlined above, be more effective than extending the public sector reform? If so, how would they be more effective and on what grounds would they be preferable to extending the public sector reform?

A possible hybrid between options 1 and 2 which included a method for the PSC to indemnify the engager and a flat-rate CIS style deduction could potentially work better for the private sector.

Other issues

Q34. Are there any other issues which businesses or individuals who may be affected would like to raise?

No.



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