

RESPONSE TO HMRC DISCUSSION DOCUMENT

INTERMEDIARIES LEGISLATION (IR35)

25TH SEPTEMBER 2015

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ABOUT PRISM

PRISM is a not for profit trade association that represents service providers offering support services to workers operating as temporary workers and contractors.

Our members include payroll service providers, umbrella companies and accountancy firms with specialist offerings to workers operating through their own limited companies, often referred to as PSCs.

One of PRISM's main objectives is to create a stable, orderly market that promotes high standards and compliance to the rules that apply across the sector. In achieving this it will provide our members with a high degree of certainty and confidence allowing them to develop long-term strategic plans and invest in the growth and development of their businesses.

Our accredited providers have already made significant investment into their businesses to support HMRC compliance.

They have trained and developed expense teams to monitor the expense claims and ensure only those expenses that meet the rules are allowed as well as internal compliance monitoring functions. There has also been significant investment made in to achieving independent verification of their compliance through reviews such as Professional Passport.

We also offer to work with HMRC, and other government departments, to develop what compliance may look like in the future and agree working operations and practices that would bring greater transparency across the market and revenue to HMRC without adversely impacting the recovery of the economy.

We are happy to inform, consult and work with government ministers, MP's, civil servants and wider stakeholders to achieve this objective.



Our members are:

Atlantic Umbrella
Black Diamond
Crystal Umbrella
Danbro
Focused
I-PAYE
Lesters
Nasa Consulting
Orbital Payroll Group
PayStream
RACS Group
SPi Accountancy
Sterling
Thornberry
TJW Contracts
Vanilla Umbrella

EXECUTIVE SUMMARY

PRISM accepts that there are issues in the market on the consistent application of IR35.

We also believe that many of the already proposed changes will alter the shape of the market and the situation in relation to IR35.

For this reason we feel that now is not the time to carry out the assessment of IR35 as it is based on historical information which, as all the proposals suggest, will not be the case in the future.

We also believe that 'reforming' the legislation is not the answer.

As the market has matured significantly over the time since IR35 was introduced we feel that a broader review of legislation applying to the sector is what is required rather than continually applying 'sticking plasters' to the current framework that results in further complexity.

The speed of change and volume of proposed changes is now reaching a point that will damage the market as the impact of the changes has not been fully considered or understood.

Learning from previous change is being ignored and no attempts seem to be made to correct and align recent legislation changes to ensure it works as intended.

There is significant learning that can be taken from the construction sector with the application of the SDC test. This learning suggests that the SDC has the same failings as IR35, in so much as it is complex and difficult to deliver an outcome with certainty.

We believe that time should be spent getting this area to work effectively before any consideration is made to extending the tests reach.

The construction sector has also shown the risks of pushing the responsibility of making the assessment in to the market, especially when coupled with a liability where that assessment is incorrect. This has created significant market distortions.

Similar trends are emerging in construction that we saw in the early days of IR35, including:

- Insurances to cover risks
- Inconsistent application
- Growth in non-compliant structures
- Compliant businesses at a commercial disadvantage

All of this needs to be fully understood before making further levels of change.

RATIONALE FOR CHANGE

PRISM accepts that there are issues in the market and IR35 is not applied consistently across all PSCs. There are a number of factors that have supported this that the document fails to highlight, these include:

- The legislation being unclear and ambiguous
- Lack of effective enforcement
- A wide variance in the quality of commercially available assignment review services available to PSC workers
- Many assignment reviews being supported by insurance against IR35 penalties and tax
- Providers reluctant to 'get involved' due to Managed Service Company Legislation risks

The document does highlight the complexity of obtaining an accurate assessment and we fail to see how making this the responsibility of another party will deliver a more accurate outcome.

We will comment further on each of these later in the document.

The document highlights the 'deterrent effect' that IR35 has had with many workers who could justify having their own PSC but actively decide to operate through umbrella arrangements with the income fully assessed for PAYE.

There appears to be a failure to recognise that the situation in 2000 when the legislation was first introduced is no longer the same as it stands today.

In the late 90's there was evidence of many large companies moving workers from employee to temporary workers and in some cases these workers returned to carry out the same job at the same desk. This came about for a number of reasons:

- The total cost of employment increased with many of the workers additional benefits, such as pensions, becoming increasingly costly for the employers to provide.

This also included the significant costs held by business where they needed to adapt and change in their market. Permanent employees are costly to remove from the business where they do not have the new skills required by the business at that time.

- Large businesses were focussed on efficiency which was evidenced by their profit derived by employee measure. The temporary workers were 'off book' and therefore did not impact that figure negatively. Where permanent employees were moved to temporary roles it had a positive impact on the figure.
- The changing shape of business employment models partly being driven by significant technological changes.
- The fear of the 'Millenium Bug' and the requirement to significantly increase IT workers to fix, what was, a short term issue.
- The desire by workers for more flexible working arrangements. These were evidenced by a growing number of flexi-time contracts for permanent employees as well as the growing contractor sector.

As many large businesses have already made structural changes and now operate in line with the CBI's view of the modern workplace many of these factors are no longer driving motivators.

Previous Reviews Carried Out

There have been many experts involved in reviewing IR35 over recent years. The consistent outcome has been that there is no simple answer.

Following the Office of Tax Simplification review the IR35 Forum was established. This resulted in the Business Entity Tests designed to provide an assessment of how likely you were to be enquired in to. Once again this failed to deliver any significant result. Whilst enforcement activity was increased ten fold this was from a very low starting point and overall compliance activity is low in relation to market size.

One positive that did come out of the Business Entity Tests was that at the point of enquiry the worker was asked to confirm whether they had considered their status and where they had to provide evidence. We saw a number of situations where workers enquiries were dealt with swiftly and confirmed that they would not be looked at again for at least three years.

Compliance Enforcement

Prior to the increased focus on IR35 there were generally less than 25 enquiries opened each year; not all of these resulted in wins for HMRC.

This low level of enforcement has meant that the balance between risk and reward is in favour of the tax payer which has rendered the legislation toothless.

Even with the increased focus over the last 2 years there has only been 250 enquiries from a population of thousands. What is clear is that the framework for the legislation is flawed as it is impossible to resource the compliance enforcement.

For this reason we feel a new approach should be adopted rather than persisting with the current thinking of applying sticking plasters. We will cover this later in the document.

The Modern Business Structure

As the market has matured over the last 15 years clear segments have emerged which would suggest a strategy based upon a segmented approach may be more appropriate.

We believe that it is now possible to identify workers who are operating consistently as 'career contractors'. They market their skills to a wide range of companies and travel to where their skills are required.

By creating a statutory definition for this class of workers it would remove many from the complex legislation.

It would also support those that have taken that bold step to make contracting their career as they would become easy to deal with from a recruitment company and end client perspective which would provide more continuity of engagements for them.

We cover the proposals on this later in the document.

OPTIONS TO IMPROVE EFFECTIVENESS

As set out above and at the Summer Budget, the government believes the legislation in its current form is not working as effectively as it should and needs to be reformed.

PRISM comment:

We believe that 'reform' is no more than applying sticking plasters to legislation that from outset has been seen as impossible to enforce.

We believe that a wider review of all the legislation currently in force across the sector should be carried out.

PRISM believes that this wider review would allow a simplification of the rules and ensure that service providers were able to support the application of compliance in the market.

Anything short of this creates further levels of complexity and likely to result in significant market distortions.

A common theme across all government documents is 'creating a level playing field', measured between employed and temporary worker levels of tax, which fails to recognise the risk the temporary workers hold in relation to security and continuity of income.

There seems to be a lack of understanding of the changing shape of business and the employment models they now seek. The CBI highlighted this in their report 'The Shape of Business the next 10 years' highlights:

'The business environment of the next decade will be significantly different to what might have been expected just two years ago. The financial crisis and the recession that has followed have altered operating conditions by imposing new challenges and exacerbating existing ones. Businesses will respond across the organisation, moving to a more flexible, collaborative and leaner model.'

The sector is currently subject to unprecedented levels of change which includes:

- Impact of the Finance Bill 2015 and the new provider arrangements that will result.
- Proposed new tests relating to supervision, direction and control across both employment intermediaries and PSCs and the impact this will have on workers.
- Changes to dividend taxation applying from April 2016.

In addition agency reporting has now been implemented and provides HMRC with up to date market intelligence and the ability to apply a more targeted compliance approach.

PRISM believes that the impact of all these changes needs to be fully understood to provide a relevant commentary on the way forward with IR35. The current stated positions refer to historic market conditions which will change as a result of the above changes.

Using historic market conditions to develop a long term answer to a problem will result in incorrect conclusions and may well fail to address the issue within the 'new world'. If there is an issue in the 'new world'.

CONSISTENT THEMES

Whilst we believe that the review of IR35 should be commenced once the full impact of the new legislation is understood there are some common themes that have emerged that we believe will continue to be in existence regardless of the proposed changes.

Commercial Assignment Review Services

There are a wide range of commercially available assignment reviews in the market. The quality of these varies widely.

Whilst workers pay for these reviews there are no consequences to the providers where the review is subsequently shown to be incorrect.

This is not a concern for the providers of these services as the volumes of reviews carried out by HMRC is very low and therefore it is rare for one of their clients to be enquired in to.

It is difficult for workers to differentiate between the reviews and often the service selected is based on price.

The companies seeking to deliver an accurate assessment are often at a commercial disadvantage as the process is complex, as the document confirms, and therefore costs more to gain an accurate assessment.

As the assessment relies on workers understanding and interpretation of their relationships this can affect the outcome.

Insured Solutions

Many of the reviews offered at the lower end of the market are supported by an insurance against penalties and tax if the worker is found to be inside IR35. In extreme examples these insurances can be obtained by workers 'self-assessing' by answering a few simple questions.

The use of these arrangements is actively undermining compliance in the market and we believe that many will not provide the security implied.

A close review of the policy terms and conditions suggest that the insurers have

a simple get out clause in the unlikely event that an enquiry is opened.

We believe that many insurers are simply betting on the low level of compliance enforcement versus size of the market and the likelihood of a client having an enquiry.

In extreme cases we are surprised that the Financial Conduct Authority has not looked closely at this as there are many similarities with other recent mis-selling scandals that have hit the financial services sector.

Once again these arrangements only remain a viable alternative where HMRC are unable to deliver compliance activity at an effective level.

Visible Enforcement

Effective enforcement of the rules is a critical aspect in ensuring consistent application.

HMRC now seem to be conceding that it is impossible for them to enforce the rules to an extent that would provide a real deterrent to those currently showing a disregard, estimated as 90% in the document.

Simply moving this responsibility to another party is not the answer.

Certainty

The cornerstone of every good tax system is certainty. IR35 has failed in this from day one.

Any assessment made always has a high degree of uncertainty as it relies on an interpretation of complex relationships.

Any change needs to deliver a set of rules that can be easily interpreted by the layperson without the need for a professional intervention.

Unless each of these points are successfully addressed we believe the effectiveness of the legislation will be undermined and market distortions will persist.

POSSIBLE CHANGES

Categorisation of Workers

HMRC seem to consider that certain employment categories or sectors will predominately be caught by IR35. This being the case we would encourage HMRC to develop a list of 'caught' occupations in consultation with the sector.

Where a list of 'high risk' occupations/sectors could be developed then IR35 could be considered to apply unless the worker provided evidence to the contrary.

Creating a framework for the evidence would ensure a consistent level of information and allow a simpler targeted enforcement to apply.

The deeming provision could also apply to all workers exposed to the rules within their first 2 years of operation. Each of these workers would be assessed as within IR35 unless they provided evidence to the contrary.

The overall effect of this would mean that HMRC would be provided with information that would allow them to have a more effective and targeted approach in applying the legislation.

Career Contractor

It is now widely accepted that many skilled workers actively decide to follow a 'career' in contracting; marketing their skills to many organisations.

Current legislation fails to recognise these workers.

Career departments in the education sector are now discussing with the students 'portfolio employment' which in our language is contracting.

We feel that a statutory test should be developed that would allow the 'career contractor' recognition of that fact and, where they qualify, allow them to operate in the same way as any other small one person limited company.

This would provide the genuine career contractor with a commercial advantage in the market as both engagers and recruiters would actively seek them out for

engagements as they would be far easier to deal with and hold no risk of liabilities.

We also believe that removing these contractors from the complex tests and reporting would help HMRC focus their enforcement efforts and resources in the areas most needed.

Initial thoughts for a statutory test would include areas such as:

- Operate through their own limited company
- Operated 3 years
- Demonstrable multiple contracts
- Multiple sites
- Multiple clients
- No engagement representing more than 40% of income over 3 years
- Average rolling three year income equal to, or in excess of £30,000 per annum which equates to approximately £16 per hour at 40 hours per week over 48 weeks.

This would further assist HMRC enforcement as the numbers of PSCs requiring monitoring and complex enforcement would reduce as the numbers of career contractors increased.

We would welcome discussions with HMRC on developing this further and accept that the tests would need to be applied over a prolonged period.

Alignment of Tests

Whilst logic suggests that aligning the tests across the sector would provide a more straight forward approach we do not believe that supervision, direction and control are the correct tests.

We believe that the tests on supervision, direction and control are not correct and are as vague as the current test within the legislation.

These test are already in existence within the construction sector and we believe that more time needs to be spent in getting them working within that sector, even to the point that new tests are developed that prove more robust in application and outcome.

This consistent application needs to be achieved before there is any consideration of extending the application of the tests.

Responsibility and Liabilities

What we have seen in the construction sector is that the risk appetite of the company that is engaging the workers is determining their position in relation to the outcome of the SDC tests.

Many companies feel the tests are vague and hard to determine with certainty and therefore they are forced to take a risk adverse approach to their application.

This risk adverse approach is resulting in many workers being wrongly put into a PAYE solution like an umbrella even though they are genuinely self-employed. It is also providing a commercial advantage to companies that are prepared to apply a lower threshold to the tests or disregard them completely.

We believe that the same situation would develop if the tests were made the responsibility of the engager.

The dilemma here is that without a liability the tests become meaningless and with a liability the tests are not being applied correctly and decisions are being made on a no risk approach resulting in the worker being disadvantaged.

For this to work the tests need to be clear and easily assessed which is not the case with IR35 and has been stated from day 1.

WORK WITH PROVIDERS

Working with responsible providers to agree what compliance looks like would benefit the market and increase compliance, as was also highlighted by The Low Income Tax Reform Group report.

As indicated in the round table meetings and over many years responsible providers see themselves as adding value to the UK Labour Market and are not involved in tax avoidance or evasion. They have invested significantly in their offerings and are much, much more than a payment intermediary.

It would also allow HMRC to issue strong guidance to the market on the definition of compliance meaning that recruiters would be able to more easily differentiate between non-compliant and compliant providers.

This project could also review MSC legislation looking to allow providers greater control when working with PSCs.

The MSC legislation prevents a provider from having any control and therefore they are unable to influence how the workers operate the company affairs.

This lack of control has also resulted in many companies either failing to pay, or paying late, their taxes that are due including VAT and corporation tax, this was not the case pre MSC.

Working more closely with providers would help HMRC increase their tax take in a simplified manner. As a suggestion it could be agreed that tax, where a provider holds monies, be paid to HMRC on account monthly.

Where providers have no control they cannot be held accountable; where they do have control they could be held more accountable.

THE LONG TERM VIEW

As is now widely recognised by employment groups and professional bodies contracting and temporary workers are an important and growing element of the working population.

This style of working brings many new challenges across many government departments and PRISM believes that it is essential to develop a long term strategic approach to this population.

In developing this strategy a rounded view and understanding of the sector can be developed resulting in, we believe, simplified legislation, increased compliance and at the same time maintaining the UK plc advantages of the flexible workforce.

This approach would also bring stability to the market and remove the constant application of new rules designed to address unintended consequences of new legislation.

PRISM is keen to become part of a working group to develop these long term strategies with government.