The Case For Structural Reform

A review of the reviews on
Modern Employment

PRISM

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About Us

PRISM is a not for profit professional trade association that represents and promotes its members' interests who all operate within the professional payment intermediaries sector.

The sector covers providers who offer support to temporary workers and recruitment companies by providing payroll services, employing workers through an umbrella company structure, and accountancy services support to workers who operate through their own limited company, often referred to as a PSC.

The members elect an Executive Committee, and this directs the Association's priorities and activities.

Introduction

In this review of Modern Employment, we will pull together many of the comments and recommendations from other papers including the Government's own review carried out by Matthew Taylor. We will seek to demonstrate how these align to our proposals and address many of the issues currently being wrestled with.

Whilst the document looks at the broad subject of Modern Employment, including tax, we do focus on the contracting sector.

There are three guiding principles that have underpinned our work and recommendations in this report:

Simplicity
The test of simplicity is whether an individual tax payer can understand the rules and be clear on how they apply to their situation.

Every commentator on the subject concedes that the rules are too complex and requires legal and tax expertise to stand any chance of understanding them. Even those that do understand them often come to different conclusions given the same set of circumstances. This must be a clear indicator that not all is well.

'Determining whether you are an 'employee', a 'worker' or genuinely self-employed requires the ability to understand complex legislation, which is spread over many Acts, and be aware of a mountain of case law. For individuals, not knowing your employment status means not knowing what employment rights you deserve. For businesses, this situation can lead to uncertainty about their responsibilities and what can be demanded from workers10. The situation does not need to be this complicated.' [Law Society]

Compliance
Creating a set of rules that encourages compliant behaviours with significant risks for those seeking to circumvent the rules. The rules should be clear, unambiguous and provide certainty of outcomes.

Recent legislation introduced has, on close examination of the facts, had the opposite effect to the extent that in some cases the rules have built in incentives for non-compliance, commercially disadvantaging those seeking to apply the rules as intended.

Ultimately, compliant firms lose out. Competitiveness in the industry is undermined because firms are competing not on their business strengths in the market but on the level of risk they are ready to take in relation to compliance and interpretation of the law. When firms mis-classify workers, the Treasury and taxpayer lose out. [SMF]

Enforcement

It doesn't matter how thick you make the rule book if it is not being visibly enforced there is no incentive to read it.

It is our belief that many of the added layers of legislation would have not been required had there been effective enforcement of the original set of rules.

Complexity adds to the opportunities for non-compliance and makes enforcement more costly and time consuming often leaving HMRC failing to recover all the taxes due.

Non-compliance is facilitated by the complexities and uncertainties that characterise employment law and practice. These uncertainties make enforcement simultaneously harder and more necessary. [SMF]

Providing a range of individual employment rights does not ensure that employers will comply with law, so it is vital that workers can rely on an effective enforcement system to protect their rights ….. And it's vital that enforcement agencies have the resources they need to make a difference. [TUC]

In developing our thinking in line with our key guiding principles we have also ensured that any recommendations made pass the following tests:

- Fairness
- Transparency and clarity
- Certainty
- Consistency

PRISM believes for these objectives to be achieved a more strategic approach is required which will result in structural reform to the current rules and tax framework.

Introduction

What is needed, therefore, is a fundamental review to establish a tax, regulatory and benefit system that fits the purpose of the UK's labour market and that can prove resilient to future change. In particular, our reform framework needs to be right for individuals and businesses, offer a better deal for the UK taxpayer and be easier to enforce. [SMF]

There are a unique set of opportunities that exist at present to achieve this:

1. Any changes could be aligned, and clearly signposted, to coincide with Brexit giving business a clear message outlining the employment and tax environment that would exist in a post Brexit world.

2. There is also the opportunity to ensure that any changes are included to the development plans of Making Tax Digital preventing complex, expensive and confusing updates shortly after rolling out the new system.

Many of the suggested changes will require developments on the Government systems as well as the need for businesses to prepare and adapt. For this reason, we are advocating a phased approach supported by a clear roadmap of developments throughout the term of the Parliament.

Closing the tax gap is not easy. If the differences in status are sufficient to incentivise certain behaviours to reduce tax liabilities or other responsibilities, enforcement plays a fundamental role in ensuring compliant practice. Yet, the more complex and uncertain the rules, the harder and more costly it is to enforce. [SMF]

Executive Summary

With the tax and employment system struggling to cope with modern style employment and ensuring that workers are classified correctly we have carried out a review of the reviews that have currently been published on this area.

These include:

The Taylor Review in to Modern Employment

The Social Market Foundation Review of self-employment and employment in the UK

The Law Society response to The Taylor Review

The TUC - The Gig is Up

The Chartered Institute of Taxation response to The Taylor Review

We have also drawn on comments made on the subject by a wide range of commentators.

In carrying out the review it was clear that there are many common messages, whilst the answers may differ, the areas that need addressing seem to agreed upon.

Tax has been an issue highlighted by many with few prepared to offer solutions. In this review we make proposals to align the tax framework with Modern Employment.

The recommendations in the report suggest a phased approach needs to be adopted with a clear roadmap to help business change and adapt for the changes.

1. Zero Hour Contracts and Limited Hour Contracts

Examining this area suggest that the current framework tax framework has built in financial incentives that could be influencing the style of engagement used by employers. Without addressing these it will be difficult first it will be difficult to understand the true scale of the problem.

The report makes the following recommendations to redress the balance:

- Remove Employers NI threshold on taxable earnings
- Recalculate and lower the Employers NI headline rate payable by employers
- Change pensions auto-enrolment rules to require employers to make the employer contribution on non-eligible job holders

These recommendations should be phased in over a 2-year period allowing Government systems to be developed and aligned to the new rules as well as providing the time for business to prepare, adjust and adapt.

2. Transparency

A theme that runs across many reports is a lack of clarity and understanding by the worker as to the arrangements they are entering in to with many unclear on their status and rights.

This lack of transparency extends beyond worker status and rights and, as we have seen with the new rules around expenses for contractors and the off-payroll rules in the public sector, it has resulted in many workers confused as to the real value of an assignment being offered to them.

These issues extend across the whole market and do not just affect the low paid workers although we recognise that there are specific issues relating to low paid workers.

With the fees for employment tribunals now removed it becomes increasingly important that workers are clear on the arrangements they are entering in to and the status and rights that relate to the arrangements; transparency plays a critical role in bringing this understanding. Without this clarity, there is a real danger that many cases will be brought because of a lack of understanding and put unnecessary pressure on the system.

In this section, we look at the following issues relating to transparency:

- Worker status and rights
- Temporary workers assignment rate
- Assignment Status

The report makes the following recommendations in these areas:

Worker status and rights

- Where a worker is engaged on any arrangement outside of 'traditional' employment then a statement should be provided explaining their status and rights under the arrangements.
- This statement should be provided at the point of offer.
- Government should work with trade bodies and representative groups to develop a range of standard templates.

Temporary workers assignment rate

- Introduce a 'standard calculation' where all rates advertised are then brought in line with a meaningful value that workers can easily compare.

Assignment Status

- Where different tax treatments could apply to an assignment then the recruiters, and for direct engagements end clients, should disclose the assignment status alongside the rate offered.
- Consider how the Intermediary Reporting could be enhanced to include assignment status.
- Remove the Relevant Salary Sacrifice test on allowable expenses for umbrella companies; the rule appears to be superseded by the SDC rule and adds a layer of complexity with no real benefit.

3. Determining Employment Status

This is the area that most commentators have focussed on with wide ranging suggestions on how employment status should be assessed.

Through this section we will look at, and assess, both the current rules and many of the proposals made together with how recommendations already made in the report would help in this area.

The report makes the following recommendations in this area:

- Government carries out a review of employment status as a matter of urgency with a view to achieving simplification, clarity and certainty of outcomes. This must incorporate the concept behind IR35 and distinguishing between a person genuinely in business on their own account and a disguised employee, to use common terms.
- Government stops any amendments, updates or new legislation in this area until the review is completed.
- As previously suggested, remove the employers NI threshold and reduce the headline rate.
- Reform the tax system to allow payment of 'Employers NI' without an associated employee. This should allow an employers NI payment to a company reference.
- Amend the debt transfer rules.
- Compel all parties to provide accurate information to the next party in the chain. Where information is knowingly provided that is false then any liabilities should pass to the party that provided the misinformation.
- Consider a Financial Services style approach to enforcement.
- Ensure the name and shame principles are applied where any provider receives a penalty for systemic non-compliance.

- As part of a strategic review, and in line with the principle of simplification, a full review of existing legislation should be carried out to identify areas of duplication, complexity, and uncertain outcomes.

- Government stops any amendments, updates, or new legislation in this area until the review is completed.

4. The Way Forward

As everyone involved, including Government, concludes this is not a simple problem to solve.

By the wide-ranging views on how to solve there must be an acceptance that not everyone will agree with the final outcome, however everyone seems to agree that something needs to be done. Doing nothing is not an option.

The report makes the following recommendations in this area:

- Government sets up a panel, made up of the bodies that have published reviews on the subject, to create a framework for debate and consideration.

- This framework should be used to underpin the Government Review we are suggesting.

5. Equalisation of The Tax System

Once again this is an area that has been commented on, but few have failed to offer solutions.

What all seem to agree on is that the main difference in the tax system across the engagement models relates predominately to Employers National Insurance.

6. The Gig Economy

The issues that have been thrown up by the success of many gig economy firms are not new and have done nothing more than expose weaknesses and opportunities that have been inherent in the tax and employment framework for years. It is, we would suggest, the fact that by utilising modern technology firms are able to develop their businesses to a significant size in a relatively short time frame and it is this success that has drawn so much attention.

A key element in the design of status assessments is that they don't focus just on addressing gig economy firms and seek to ensure that a level playing field is achieved across all businesses within a sector.

7. Enforcement

PRISM believes that any enforcement must be underpinned by the following:

- Enforcement must be visible to serve as a deterrent to those that seek to exploit, or disregard the rules. To achieve this, and in the current complex environment, more resources will be required.
- Enforcement agencies should be able to act as fast as modern businesses can; that way they have a chance of recovery as well as quickly stamping out non-compliant behaviours.
- Liabilities for non-compliance must be constructed in a way that allows third party users of non-compliant services an appeal process where due diligence can be demonstrated. Without this market distortions will occur.
- Name and Shame rules should be updated to allow the publicity of offenders, as well as details of the offence.
- Where rules are complex, as they are currently, those making best endeavours to comply with the rules as intended should experience a collaborative approach over shortcomings to help them create more robust compliance.

- On the other side companies that have systemic failings or show a complete disregard to the rules should experience the full force of enforcement.

Zero Hour Contracts and Limited Hour Contracts

These arrangements have been in sharp focus over the last few years. Action has already been taken removing the exclusivity clauses from the contracts with a view to limit their use and afford more flexibility and protection to the workers.

Figures are still showing an increase in the use although it is being questioned as to whether the increase is a genuine increase or an increase due to heightened awareness and therefore more being reported.

Whilst data suggests that there have been large increases in the number of people on zero hours contracts since 2012, this increase is, at least in part, due to an improved recognition of this type of contract. This means that we cannot know with certainty that zero-hour contracts are on the rise and in fact reported numbers have stabilised in recent periods. [Taylor]

Whatever the reality there still appears to be wide ranging views on how to deal with such arrangements.

The TUC advocate a total ban:

The government should move towards banning the use of zero-hours contracts. Individuals who work regular hours should have a right to a written contract guaranteeing their normal working hours.

Matthew Taylor suggests they do have a purpose in the workplace but ensuring protective measures are considered is essential to avoid workers being forced in to such arrangements.

We do not agree with a total ban as we have already seen suggestions from employment lawyers providing work arounds if zero-hour contracts were banned.

We believe that the route of the problem needs to be better understood and a close look at the tax system could provide some clues as to the attractiveness of these arrangements for employers.

*It is clear to us – based on evidence that was submitted to the Review – **that the nature of the tax system acts as an incentive for practices such as bogus claiming of self-employed status**, by both businesses or individuals. [Taylor Review]*

While tax (including national insurance) is not formally part of the remit of the review of employment practices in the modern economy, the CIOT believes this area cannot be considered without taking into account the substantial influence of tax differentials in driving choices of employment and business structures. We note the Chancellor's statement in his March 2017 Budget statement that Matthew Taylor had told him that 'differences in tax treatment are a key driver behind the trends we are observing.' [Chartered Institute of Taxation]

There are two key components to the UK employment tax system:

1. The cost to an individual

2. The cost to the employer

It is the second of these points that is providing a financial incentive to employers to maximise the use of these arrangements.

The current framework surrounding Employers' NICs means that employers have no liability for workers earning below £157 per week - that equates to approximately 20 hours of work per week for a 25-year-old on the National Living Wage.

..thresholds apply to Employer NICs: below £157 weekly wage no employer NICs are paid. There is therefore an incentive for firms to engage two people part-time rather than one person full-time so as to avoid making these payments. [SMF]

Where that worker was engaged with two separate employers a week, each employer could apply, and benefit from, the threshold. This practice could save an employer around £975 per annum in Employers' NICs. The position is neutral for the employee. Removing this threshold would, we believe, remove the incentive to offer limited hours or zero-hour contracts.

Employers must not use flexible working models simply to reduce costs and must consider the impact on their workforce in terms of increased sickness rates and reduced productivity; [Taylor]

If the Employers' NI threshold was removed there are three significant benefits.

1. The headline rate payable under Employers National Insurance could be reduced as more Employers' NI would be collected. If the figures were calculated correctly then companies with 'traditional' engagement methods would see a drop in their overall cost of Employers' NI. Only those companies seeking to exploit this gap would see an increased cost.

   We know from recent examples that there is little appetite or sympathy for companies that have looked to exploit loopholes in legislation in an attempt to reduce their costs and therefore we would consider that any negative responses to this proposal would be limited and not gain traction in the media.

2. Where workers had more than one job, the tax collected from businesses would be the same as a single job employee and in turn help achieve the stated objective of people doing the same job paying the same levels of tax.

3. The problem of aggregation of earnings would be addressed.

   This has become a growing problem, particularly within the NHS, with workers operating both as full-time employees whilst also supplying their services through contracted arrangements.

   In these arrangements, the worker would be on a monthly payroll with the NHS for their full-time work and generally on a separate weekly payroll for their contract work. There is no difference in the tax for the worker but a clear saving in Employers NI for the employer.

   By addressing this anomaly, and inbuilt tax incentive, we are able to differentiate between the tax costs to the individual, which would remain the same, and the tax collected through the employer contributions.

   Providing a clear notice to business of the intention to deliver this change, aligned to the timings for Brexit, would not only demonstrate a clear plan for post Brexit employment but also give business the time to adjust and adapt their engagement models.

Business has shown that when given clear direction with enough time to react they are able to do so without consequence.

This was clearly demonstrated by the soft drinks industry following the announcement of the introduction of a sugar tax. The Chancellor confirmed in the last budget that the tax raised would be less than forecast as the soft drinks industry has moved their customers across to sugar free drinks.

There is a further incentive hidden in the depths of the cost of employment that PRISM believes also needs to be aligned to level the employment playing field. Under pensions auto-enrolment earnings threshold rules means there could be additional cost savings to employers using zero-hour contracts or limited hour contracts.

These low paid workers, earning below the Employers NI threshold, would be jobholders but will fall below the auto-enrolment threshold. Their status would be non-eligible job holder.

The limited working hours guaranteed to such workers mean that earnings fall below the thresholds for National Insurance contributions and for income protections such as statutory sick pay and statutory maternity pay. [TUC]

A non-eligible jobholder is a person who doesn't have to be automatically enrolled into a workplace pension. They can ask to join the pension scheme, and the employer would have to pay monthly into their pension pots on a regular basis if they did.

Figures show that only 4% of non-eligible job holders voluntarily opt in or to put it another way 96% don't. This means that employers are saving the employer pension cost on those workers. With the cost to employers set to rise to 3% from 06/04/2019, this area of potential savings for employers is likely to come under increased focus and could support a growing framework of employing workers for limited hours per week.

Where a worker fails to 'opt in', this provides further savings of £22.88 per annum, rising to £68.64 from 06/04/2019 onwards. With staff contributions also set to rise over the period to a peak of five percent from 06/04/2019, we would expect the numbers of workers voluntarily 'opting in' to fall significantly.

Zero Hour Contracts and Limited Hour Contracts

This group of workers are low paid and often referred to as vulnerable so we propose that the cost savings to employers should be reversed.

The Low Income Tax Reform Group has pointed out, the business may be able to avoid other costs by employing workers on short hours. Employer contributions to auto-enrolment pension schemes – those on weekly earnings of below £192 do not have to be automatically enrolled – whilst employers may also be able to avoid liability for statutory sick pay. [SMF]

Employers should be required to make the employer contribution for all non-eligible job holders regardless of whether they have opted in or not. If the workers earnings reached a level where they became an eligible jobholder and decided to opt out then the employer would no longer need to make the employer contributions.

These two changes remove the incentives for employers to manage workers hours and earnings to save tax. As a result, we are more likely to see the end of abusive arrangements and workers being forced to accept these arrangements.

PRISM believes that implementing these changes would change the numbers of workers operating through zero hour or limited hour contracts. It also aligns to Matthew Taylors recognition that there is a place in the market for these arrangements. With no difference in cost to an employer between engaging a zero-hour worker or full-time employee we believe that a rebalance of employment would occur.

In Matthew Taylor's report, it was suggested that a different, and higher, level of National Minimum Wage could be applied to hours in excess of the contractual hours. We believe that this adds a further layer of complexity to the rules and would prove difficult to enforce.

We would suggest that the first phase should be to remove the financial incentives as we describe. This will allow a more accurate assessment to be made on the use of these arrangements and, if required, further actions could be considered to address any unintended consequences or abusive arrangements.

Research with employers suggests that these factors matter when decisions are made as to whether to engage self-employed workers or employees. - OTS, Employment status report (2015)

Providing business with a clear roadmap and timings would allow government to review market movements and address any unintended consequences should they become apparent.

Recommendations

- Remove Employers NI threshold on taxable earnings.
- Recalculate and lower the Employers NI headline rate payable by employers
- Change pensions auto-enrolment rules to require employers to make the employer contribution on non-eligible job holders
- These recommendations should be phased in over a 2-year period allowing Government systems to be developed and aligned to the new rules as well as providing the time for business to prepare, adjust and adapt.

Transparency

A theme that runs across many reports is a lack of clarity and understanding by the worker as to the arrangements they are entering in to with many unclear on their status and rights.

This lack of transparency extends beyond worker status and rights and, as we have seen with the new rules around expenses for contractors and the off-payroll rules in the public sector, it has resulted in many workers confused as to the real value of an assignment being offered to them.

These issues extend across the whole market and do not just affect the low paid workers although we recognise that there are specific issues relating to low paid workers.

With the fees for employment tribunals now removed it becomes increasingly important that workers are clear on the arrangements they are entering in to and the status and rights that relate to the arrangements; transparency plays a critical role in bringing this understanding. Without this clarity, there is a real danger that many cases will be brought because of a lack of understanding and put unnecessary pressure on the system.

In this section, we look at the following issues relating to transparency:

- Worker status and rights
- Temporary workers assignment rate
- Assignment Status

Worker Status and Rights

PRISM has been working with the Low Income Tax Reform Group to develop a workers information sheet, aimed specifically at the lower paid worker, to help them understand not only their employment status and rights relating to both Agency PAYE and Umbrella but also the true value of the rate being offered.

The first step is clarity for the worker on their status. This is essential to raise compliance in the market. The worker information sheet aims to address this. The sheet is becoming widely available as well as being provided by PRISM members voluntarily to all new joiners.

On worker status and rights it states:

You are an employee of the umbrella company and so have the same rights as any other employed person. These include the right to be paid the minimum wage, the right to paid holiday (more on this later), the right to be auto-enrolled into a pension (if you meet the earnings threshold) and to statutory benefits such as sick pay and maternity pay (provided you meet the relevant criteria). You can find more information about employee rights on GOV.UK: https://www.gov.uk/employment-status/employee

It is worth noting that as an agency worker, you would get the main employment rights even if you didn't work through an umbrella company. Working through an umbrella company can be beneficial in other ways however. For example, it can provide a continuous payroll link from one assignment to the next, preventing problems like 'emergency' tax when you start a new assignment through a new agency. Sometimes they also provide things like shopping discounts and an online portal where you can track your pay.

Whilst PRISM members, and some other responsible providers, have decided to voluntarily distribute this information to workers we believe that confirming status and rights to workers on engagement would be a positive step forward.

The government should encourage increased transparency in the employment relationship. … Agency workers and those working for sub-contractors often do not know who their legal employer is. As a result, they face difficulties enforcing their rights. - TUC

Recommendations

- Where a worker is engaged on any arrangement outside of 'traditional' employment then a statement should be provided explaining their status and rights under the arrangements.
- This statement should be provided at the point of offer.
- Government should work with trade bodies and representative groups to develop a range of standard templates.

Transparency

Assignment Rate

The rate being offered is a key driver in any worker deciding which assignment to take and through which agency. Often workers are unclear that whilst a rate appears higher from a particular agency this may not result in them taking home more money. This could be as 'agency 1' rate is a PAYE rate, with the agency paying the employment costs on top, and 'agency 2' rate is the rate where the worker operates through an umbrella company.

Where the rate is 'uplifted' for operating through an umbrella this uplift should be sufficient to cover the employment costs and deductions made by the umbrella company. Where this is the case the worker's position should at worst be neutral.

As the market has moved with fewer recruitment companies offering engagement through their own PAYE arrangements we have seen the uplift being eroded and, in some extreme examples typically at the lower paid end of the scale, no uplift being applied.

One of the consequences of this has been the emergence of arrangements that seek to either ignore or circumvent National Minimum Wage rules, the most prevalent of these became known as 'pay day by pay day'.

Example

Agency 1 offers an assignment at £12 per hour with Agency 2 offering exactly the same role, with the same end client at £13 per hour.

On first glance, it would be reasonable to assume you would take the role through Agency 2 however Agency 1 is offering it as a PAYE rate with the worker being engaged on the agency payroll and the agency bearing all the employment costs on top. Agency 2 is offering it as an umbrella rate, which includes the employment costs within the rate.

Assuming average charges by an umbrella the equivalent umbrella rate for the worker to remain neutral would be £15.30. So in the example above the worker would be worse off on the £13 per hour rate compared to the agency PAYE rate of £12.

Once again this has been addressed in the worker information sheet we have developed and this states:

How much will I be paid if I work through an umbrella company?

This is where things can get quite complex—so much so, that people often think they are being 'scammed' by an umbrella company when they get their first payslip. But let us explain once and for all how things should work.

If you are paid by an agency directly, then the rate they offer you (commonly known as the PAYE rate) is the amount, before your tax and National Insurance, that you should receive. So if you have a PAYE rate of say, £9.50 per hour and work 35 hours you will be paid £9.50 x 35 = £332.50 as gross taxable pay. You will then have your PAYE tax and employee NIC deducted from this, in the same way as all other employees. But £9.50 is not the true cost to the agency of paying you. In addition, they may have to pay things like Employers' NIC, holiday pay, apprenticeship levy and contribute into a workplace pension. As such, the cost to them of taking you on, may be something more like £12 an hour. But you aren't entitled to the full amount of £12 —you are only entitled to the £9.50. Hopefully you are familiar with this concept from any other employments you have been in.

When an agency hands you over to an umbrella company, they should pass the umbrella company the full costs of your employment—i.e. the £12 an hour (from the funds they themselves have received from the end client). This is commonly known as the limited company rate. They may explain to you that you can get £9.50 an hour if you are paid through them, or £12 an hour if you are paid through an umbrella company. The 'headline' rate of £12 an hour can sound like a great deal if the agency do not properly explain to you that it is intended to cover the total costs of employment and is not the amount you are going to personally earn! As such it can be very tempting to go with the £12 an hour—but you may then get a shock when you get your payslip and see things like Employer NIC being deducted.

The bottom line however is that the limited company rate should be sufficiently more than the PAYE rate, so that once all the additional employment costs have been deducted, and the umbrella company charge has been deducted, you are in no worse a position than if you had just received the PAYE rate in the first place.

This can be very hard to work out unless you are a tax expert or have some special computer software to do the maths for you, so to help you we have prepared a table (over the page) that shows, approximately, what the minimum equivalent limited company rate should be for some common PAYE rates.

Transparency

TIP: Ask your agency for both their PAYE rate and limited company rate when looking at a potential assignment.

It also provides a 'ready reckoner' for workers to make a quick comparison on rates:

PAYE rate v Limited company rate—Ready reckoner

PAYE rate	*£7.50*	*£8.00*	*£8.50*	*£9.00*	*£9.50*	*£10.00*	*£11.00*	*£12.00*
Ltd Co rate	*£9.50*	*£10.15*	*£10.80*	*£11.45*	*£12.10*	*£12.75*	*£14.00*	*£15.30*

Please note that this is just a 'ready reckoner' but should help you understand whether what you are being offered to work through an umbrella company is roughly right. For the purposes of this table, we have assumed that a worker is working 35 hours per week and that the umbrella is making a £20 'margin' a week (i.e. the charge for their services). This margin should be factored into the limited company rate —if the umbrella company charges more, the equivalent rate will be slightly higher and if they charge less the equivalent rate will be slightly lower.

This table is based on the 2017/18 rates and allowances for things like Employer's National Insurance and auto-enrolment. For anyone with a technical interest in the figures, they can be found on GOV.UK, for example here: https://www.gov.uk/guidance/rates-and-thresholds-for-employers-2017-to-2018

TIP: If your circumstances do not fit neatly within this table then give the umbrella company the PAYE rate and the limited company rate you have been quoted by the agency. A good umbrella company should help you understand what the rates mean and to the extent they don't even out—which one works out best for you.

Recommendations

Many agency workers have also raised concerns that they were not always made aware that it would be an intermediary that would become responsible for paying their wages and making deductions, even though the recruitment agency is required by law to make this clear. This situation has not improved and while most employment businesses that originally place the work seeker do provide information about pay rates and methods, this is not always as clear as it should be. More unscrupulous providers can bury important information in the small print of long contracts. [Taylor]

- Introduce a 'standard calculation', similar to that used in the worker information sheet, where all rates advertised are then brought in line with a meaningful value that workers can easily compare.

- All roles, that are not offered on an agency PAYE rate must use the calculation and advertise a 'PAYE equivalent rate'. This will help workers see the true value of the rate and understand what, if any, uplift is being applied.

Assignment Status

Over the past few years we have seen a range of tests introduced that impact both the status of a temporary worker and the tax treatment of their income.

Whilst PRISM does not believe the structure of the tests are correct, we cover this in more detail later in the report, we do feel it worth highlighting issues relating to these under the 'transparency' agenda.

As we have already highlighted the rate is a key driver in workers deciding what assignments they will take and through which agency.

As assignment rates increase other factors come in to play that influence the true value of an assignment to the worker. We will cover these under the following headings:

- PSC Contractors

- Umbrella Workers

- CIS Workers

Transparency

The benefit of transparency also extends to workers and those looking to work in a particular role or sector. Better information means that workers can take informed decisions about where and how they want to work. [Taylor]

PSC Contractors

The issue, solely relating to transparency, for these workers is the status of their assignments.

Currently all assignments are offered with a rate and the worker selects which assignment and rate they wish to apply for. However, the true value of an assignment to the worker can vary dramatically depending on its status.

The current test on an assignment status is generally known as IR35. Where an assignment is caught by the IR35 test claimable expenses become restricted and the income, in the main, is taxed fully under PAYE.

For a specialist worker looking to take an assignment away from their residence this could have a dramatic impact. If they were to travel to the area and stay in a hotel Monday to Friday for the duration of the assignment then none of these expenses would be allowable if the assignment was caught by IR35.

For PSC contractors understanding the status of an assignment is becoming increasingly important in their decision on which assignments to take.

Without getting in to IR35, we do this later, there is a key principle that needs to be considered here. Some assignments will be, whatever the test, seen as working in a way akin to an employee and, under the general principle of fairness, will be taxed in the same way. The issue to highlight under transparency is the disclosure of these arrangements.

We believe that where a rate offered for an assignment could have multiple tax treatments applicable to it there should be a disclosure requirement on which one applies.

This allows workers to assess the true value of an assignment would enhance the markets competitiveness as obviously assignments caught by the rules may need to offer a higher rate by way of compensation.

The transparency also creates simplicity and a far simpler enforcement regime can be in place.

Recommendations

- Where different tax treatments could apply to an assignment then the recruiters, and for direct engagements end clients, should disclose the assignment status alongside the rate offered.

- Consider how the Intermediary Reporting could be enhanced to include assignment status.

Umbrella Workers

We have heard from some who would like to see umbrella companies removed from the supply chain altogether. However, we do not believe this is a proportionate response to the issues faced. That said, while umbrella companies have played a legitimate role in higher skilled, higher paid sectors for years, at the lower paid, lower skilled end, their role is more questionable for a number of reasons. For instance, agency workers are generally charged between £15-35 per week in admin fees when paid through an umbrella company – something that would be unlawful if these deductions were made by the employment business themselves. [Taylor]

In addition to comments already made on transparency for umbrella workers we would also like to highlight the following. Over recent years the umbrella providers, and their workers, have been subject to significant changes to their operating rules which have resulted in a less clear position for both the companies and the workers.

We also believe individuals should have greater choice in the way in which they receive paid annual leave. As a general rule, annual leave entitlement equates to 12.07% of hours worked. We believe individuals should have the choice to be paid for this entitlement in real time – known as "rolled-up" holiday pay. This would result in dependent contractors receiving a 12.07% premium on their pay. So in the case of someone being paid the NLW of £7.50, their actual remuneration would be £8.41 an hour. Additional safeguards would have to be built in to ensure individuals did not simply work 52 weeks a year as a result, but we believe giving individuals this kind of choice will suit many working in casual arrangements and in the on-demand economy. [Taylor]

Transparency

There have been 2 significant changes that came in to effect in the tax year 2016/17:

1. Relevant Salary Sacrifice Test – Finance Act 2015

   This rule was introduced in line with the changes made to employer expenses rules and the removal of dispensations. It specifically targets umbrella companies and prevents an umbrella company from reimbursing expenses, even where those expenses are allowable for tax purposes.

   For a worker to re-claim the tax on these allowable expenses a Self-Assessment Tax Return must be made.

2. Supervision, Direction or Control Test – Finance Act 2016

   This rule requires the umbrella provider to carry out checks on whether the worker is subject to supervision, direction or control and where this is present it categorises each workplace as permanent. As a result no temporary workplace expenses are allowed.

   Ignoring the views on the actual test, we cover this later in the report, there are some principles relating to transparency that need to be considered.

   Where a provider carries out an assessment and concludes that the worker is outside of SDC they are prevented from reimbursing expenses due to the 'relevant salary sacrifice' test in the previous act.

   This undermines the principles of the new legislation and results in confusion, complexity and uncertainty for the workers.

   The provider may confirm their view to the worker and confirm that certain expenses would be allowable. For the tax relief to be claimed on those allowable expenses the worker would need register for self-assessment and complete a SATR. That in itself is no guarantee that HMRC would agree and reimburse the expenses. Furthermore, even where those expenses were agreed by HMRC and a tax refund applied the worker has still suffered a National Insurance cost that is not recoverable. In the case of umbrella workers and the way the arrangements work this effectively is both an Employer NI and Employee NI loss.

This process undermines transparency as workers are unable to accurately assess the true value of an assignment at the point of offer.

… as more employment businesses outsource payroll and other services to intermediaries, such as umbrella companies. In itself, this is not a problem; however, there have been examples of individuals being compelled into these arrangements or signed up to them with the detail hidden in the small print of a contract. This can result in a range of issues from a worker not knowing who their employer is if they want to make a complaint to not fully understanding pay rates. [Taylor]

PRISM believes that this also fundamentally fails any test of fairness and means that the umbrella worker effectively suffers a greater PAYE cost than their full-time employee comparator.

We would also echo the comments made in relation to PSC workers and the importance of knowing the status of an assignment, this is now the same for an umbrella worker.

With different tax rules applying depending on the outcome of the SDC assessment the worker should know before accepting an assignment whether it is caught or outside of these rules. Only then will they have an opportunity to assess the true value of the offer being made.

This transparency would enhance the markets competitiveness as obviously assignments caught by the rules may need to offer a higher rate by way of compensation.

Recommendations

- Remove the Relevant Salary Sacrifice test on allowable expenses for umbrella companies; the rule appears to be superseded by the SDC rule and adds a layer of complexity with no real benefit.
- Where different tax treatments could be applied to an assignment then the recruiters, and for direct engagements end clients, should disclose the assignment status alongside the rate offered.
- Consider how the Intermediary Reporting could be enhanced to include assignment status.

Transparency

CIS Workers

In tax year 2014/15 the Government introduced legislation, Onshore Employment Intermediaries, which requires an agency to assess whether a worker operating within the construction sector is subject to supervisor, direction or control.

Only those workers not subject to any of the categories can be classified as self=-employed.

The result was many workers being moved from self-employed to employed through an umbrella company, which at outset they were not too happy about. Ignoring the viability of the test, we cover this later, and focussing on the point of transparency once again workers should be informed on the status of assignments offered as it does impact their income and allowable expenses.

Recommendations

- Where different tax treatments could be applied to an assignment then the recruiters, and for direct engagements end clients, should disclose the assignment status alongside the rate offered.

- Consider how the Intermediary Reporting could be enhanced to include assignment status.

Determining Employment Status

This is the area that most commentators have focussed on with wide ranging suggestions on how employment status should be assessed.

Greater certainty for individuals and businesses. This will reduce the opportunities for deliberate non-compliance, whilst reducing the uncertainties and administrative burden for those seeking to comply. [SMF]

Through this section we will look at, and assess, both the current rules and many of the proposals made together with how recommendations already made in the report would help in this area.

Within employment law there are 3 recognised statuses:

- Employed
- Worker
- Self-employed

Within tax law there are 2 main status:

- Employed
- Self-employed

With a third status of 'employed for tax purposes only' specific to certain arrangements.

What the reviews say on determining employment status

The Taylor Review made the following comments on determining employment status:

The current framework works reasonably well, but needs to adapt to reflect emerging business models, with greater clarity for individuals and employers;

The focus should be clarifying the line between 'worker' status and self-employment as this is where there is greatest risk of vulnerability and exploitation;

Determining Employment Status

Further efforts should be made to remove incentives for some businesses to gain competitive advantage by adopting business models which may particularly disadvantage workers;

The aim of a new legislative framework is that the legislation does more of the work and the courts less.

The report goes on to say:

A number of considerations must be addressed if a future framework is going to support fair and decent work. As a first principle, the Government must make legislation clearer.

The employment statuses should also be distinct and not open to as much interpretation as currently, nor be so ambiguous that only a court can fully understand the basic principles.

The law should also ensure that where individuals are under significant control in the way they work, they are not left unprotected as a result of the way their contract is drafted.

It should not be as difficult as it is now for ordinary people or responsible employers to seek clarity on employment status.

Ultimately, if it looks and feels like employment, it should have the status and protection of employment.

More clearly and definitively stating the basis for employment status in legislation will not be easy. However, as a number of organisations, including the Law Society recognise, there is now an overwhelming case to tackle this sooner rather than later.

Getting this right is not only about protecting individuals. Businesses too want to ensure they are operating on a level playing field when complying with their legal responsibilities and not being undercut by less responsible employers seeking to play fast and loose with ambiguous legislation. Many of the submissions to the Review from business groups called for greater clarity in the legislative framework.

In developing the test ……., control should be of greater importance, with less emphasis placed on the requirement to perform work personally.

We suggest that the system [Employment Tribunal] be changed to create a presumption of employment or worker status (depending on what the individual claims), shifting the burden onto the employer to prove that this is not the case.

The Chartered Institute of Taxation commented in their response to the Taylor Review:

The tax issue interacts in a complex way with both people's employment rights vis-à-vis their employer, the rights they may have as a 'worker' regardless of strict employment status, and their social security entitlements. There is a repeated demand by HMRC for anti-avoidance legislation to counter artificial shifts toward self-employment (eg where engagers attempt to mitigate liabilities for employment rights or employer NICs). Thus there is great and increasing compliance cost, complexity and uncertainty around a worker's (including an incorporated owner-manager's) employment status.

being self-employed is not synonymous with being entrepreneurial, and there is a case for saying that it is entrepreneurialism rather than the legal status of self-employment that should be encouraged. One option to be considered for distinguishing genuine entrepreneurialism would be to adopt some form of statutory employment (versus self-employment) test for tax purposes along similar lines to the statutory residence test, introduced in April 2013. UK residence (versus non-residence) is, like employment versus self-employment, a fundamental building block of the tax system – yet in recent decades there had been regular disputes and litigation about it with the case law yielding many 'rules of thumb' but few hard-and-fast rules tending toward certainty or reliability. The introduction of the statutory residence test was carried through in a consultative manner over a long period, and, most significantly, the Government was prepared to delay implementation to allow it to be got right. The result is undoubtedly, still, highly complex, but does at least provide something like a clear 'decision tree' which can provide an answer with less need of such recurrent and costly litigation. In the case of the employment/self-employment distinction as it should be applied for tax purposes, such factors as whether labour is typically provided to a single (or very low number of) engagers over a particular period, or whether the individual provides the bulk of any tools or equipment needed, might be key elements of a more tightly defined test.

Determining Employment Status

The Social Market Foundation in their report Rules of Engagement comment:

The consequences of our current situation are severe – for the individual who suffers welfare losses, for the taxpayer who loses money, and for the business who faces compliance costs and risks associated with competitor non-compliance.

Many workers do not correctly identify their own employment status; and there is a divergence between what the firms who use their labour may be reporting and what the individuals believe. Uncertainty brings compliance costs to businesses. Ambiguity creates room for noncompliance, which undermines competitiveness in the market. Greater certainty should also, all other things being equal, increase tax revenues for the Exchequer as non-compliance falls and enforcement becomes easier.

The behaviour of a minority of non-compliant firms can potentially affect the functioning of the whole market. Small differences can make the difference between winning or losing a contract for instance in sectors such as construction, ICT and public administration. In these settings, firms and workers can win a competitive advantage by taking a risky approach to tax compliance, including by flexing the distinction between employment and self-employment. Firms that are deliberately non-compliant can claim a tax and regulatory advantage; they may also have lower costs of compliance. If those firms and workers are seen to get away with it, then others are faced with the choice of either imitating them or taking the risk of losing out on contracts.

..the focus on 'control' is common ground. International evidence suggests that the UK will not be able to create a definition which removes uncertainty entirely. However, we recommend that the Government pursue the OTS's recommendation of establishing a legal employment status. This could bring clarity as well as an opportunity to revise the current definitions. Clarifying employment status would also provide an opportunity to reconsider the role of IR35, which in the view of the Treasury's expert advisory body is 'not working' and 'unlikely ever to work practically'. In doing so, the Government should look in depth at the characteristics of those who are on the boundary of employment and self-employment, including contractors and those working through intermediaries.

The Government should carry out a strategic review of the employment status definition with a view to establishing a new legal definition which is simpler and easier to enforce.

The **TUC** commented:

The issue of employment status is vital for working people as it regulates which employment rights individuals benefit from in the workplace. However, there is a growing consensus that employment rules are overly complex, create uncertainty for managers and workers and mean that groups of workers – often those who are most vulnerable – lose out on the rights they need.

Employers can take advantage of the current uncertainty and complexity on status to avoid their employment obligations.

modernise rules on employment status and continuity of employment to ensure all working people benefit from the same floor of decent employment rights and employers cannot contract out of their employment responsibilities or misclassify staff as self-employed

A new 'worker' definition should be devised that covers all existing employees and workers, including zero-hours contract workers, agency workers and dependent contractors. The definition should extend to individuals who are employed via an agency or a personal service company. Those covered by new 'worker' status should benefit from the full range of statutory rights.

There should be a statutory presumption that individuals have 'employee' status unless the employer can demonstrate otherwise. This would go some way to giving working people greater security about their rights.

In addition to reforming the rules around employment status, UK employment rights should be enhanced to reduce insecurity and ensure that flexibility genuinely cuts both ways in the workplace.

The Law Society commented:

There is an urgent need to reform how employment status is defined. The report suggests clearer definitions for the different employment statuses. All those in paid work must be given the assistance necessary to understand what rights they are entitled to, particularly those working outside of a written agreement. All those who pay for someone's labour need to be clear what responsibilities they have and what commitment can be demanded.

Determining Employment Status

All individuals should receive a written statement clarifying their employment status and who their employer is. They should also be sign-posted to information about what rights, responsibilities and freedoms all those in the relationship have.

Determining whether you are an employee, a worker or genuinely self-employed requires the ability to understand complex legislation, which is spread over many Acts, and be aware of a mountain of case law. For individuals, not knowing your employment status means not knowing what employment rights you deserve. For businesses, this situation can lead to uncertainty about their responsibilities and what can be demanded from workers10. The situation does not need to be this complicated.

There are no simple or definitive definitions for any of these three categories and the different rights and obligations attached to each one has developed through statute and case law. The consequence of this piecemeal development is that employment status is little understood by those it most affects; those who receive money for their labour. Some businesses have seen this gap in legal knowledge as an opportunity to minimise regulatory burdens. Large groups of people are working in environments where they are denied even the basic benefits set by Parliament, including access to the National Minimum Wage, when it is not clear that this is right.

If the definitions of each employment status are clear there will be less dispute as to what employment rights different types of workers are owed. This will lower the number of disputes that have to be resolved through the adversarial process of the ET.

Perhaps due to its vague statutory definition, this term [worker] has become an all-encompassing status, applicable to all in paid work. However, the brevity of this statutory definition is no longer fit for purpose in the modern economy. As mentioned above, employee status attracts a number of statutory benefits and those unable to access these benefits are left with little option but to fight for worker status in order to access the basic minimum benefits defined by Parliament. These include access to the NMW, the right not to suffer deductions from wages or unlawful discrimination, and to be entitled to paid annual leave.

Workers have traditionally been thought of as those in a 'subordinate and dependent position'14. This remains true today. As reflected in our suggested definition, the key difference between employee and worker status is found by examining the level of control an employer retains over their activities. Where a contract includes an element of exclusivity, for example, that a driver cannot work for another private transport business, the ET is likely to infer employee status. In the same vein, where a contract places no such restriction and an individual is free to work for other businesses, the more likely they are to be considered a worker. In the absence of a clear written contract, it is vital that statute precisely sets out the types of factors which point to greater control, and therefore, a genuine worker status.

Throughout all of the commentary common themes are emerging:

- Lack of clarity or certainty of status
- Determining status is too complex
- Complexity allows some to exploit the rules or workers
- The need for change and updating the rules is both urgent and important
- Tax and employment costs are key drivers in employers' engagement decisions
- Non-compliance creates contagion across sectors
- Control is a common theme in establishing status

Each of the reviews have a range of suggestions on how to deal with the issue of employment status, with some areas of agreement.

Recommendations

- Government carries out a review of employment status as a matter of urgency with a view to achieving simplification, clarity and certainty of outcomes.

Better evidence to allow for better policy decisions in the future. This will allow future policy to evolve better in step with the contemporary labour market and promote greater scrutiny. [SMF]

- Government stops any amendments, updates or new legislation in this area until the review is completed.

Off-Payroll in The Public Sector

Off-payroll in the public sector, being the latest set of rules introduced to address issues of compliance within the contracting sector. It is worth examining these rules carefully and seeing whether they are delivering their intended results and whether they support the common conclusions reached across the broad range of commentators.

…that almost all of the provisions intended to encourage entrepreneurialism referred to in the previous paragraph have been introduced, modified or abandoned by Chancellors on Budget Day (or the day of the Autumn Statement, or some similar fiscal event), with little or no prior consultation but with considerable design detail already 'set in stone'. [Chartered Institute of Taxation]

We have looked at the legislation under the headings of each of our guiding principles:

- Simplicity
- Compliance
- Enforcement

…the tendency, therefore, has been towards more rather than less complexity. A recent example is the Off-payroll working in the Public Sector policy. ….. However, the OTS concluded in its response to the consultation that the 'proposals will not, overall, deliver simplification', citing concerns over additional administration, uncertainty about the status test results (which won't be binding) and distortions across the market as the rules will only apply to the public sector and not the private sector.[41] There have been worries that it may reduce individuals' incentive to work in the public sector rather than the private sector. [SMF]

This legislation was introduced in 2017 and requires any public-sector body engaging with a PSC contractor to assess the status of the assignment in relation to IR35. Where the assignment is caught by IR35 a prescribed payment process must be followed, we cover this in more detail shortly. Workers outside IR35 continue as before.

The differences between the pre-existing IR35 rules and the new public sector rules (despite only being introduced on 6 April 2017) are already causing distortions in the market as, for example, we hear anecdotally of media workers, doctors and IT professionals quitting the public sector (including the NHS and HMRC) to go and work in the private sector. [Chartered Institute of Taxation]

Whilst the legislation seeks to ensure that where an assignment is caught by IR35 then all the income relating to that assignment is taxed through PAYE the big prize, after the recent changes to dividend tax, is securing the Employers National Insurance contributions on the monies paid.

While policymakers have done their best to respond to market reactions and behaviours, too often this has simply sought to block off the latest undesirable practice. In turn each regulation has added more complexity and indeed sometimes perverse incentives of its own. The story is told well through the OTS chart of reforms. It shows the number of reforms and market behaviours that have adjusted the boundary one way or the other. Neither is this a complete list nor an up-to-date one. Last year we had reforms to tax relief on travel and subsistence which provides a further incentive for individuals to be classified as self-employed. [SMF]

Simplicity

This legislation was introduced quickly and therefore had to be designed within the constraints of the current tax framework, as a result the outcome is more complex than we believe it needed to be.

The following are points that illustrate the complexity of the arrangements.

1. The Fee Payer

Within the arrangements the person closest to paying the workers company becomes responsible for the assessment of the assignments status. Where they assess the assignment as outside IR35 they become liable for any unpaid taxes, if HMRC were to successfully challenge that assessment.

The Fee Payer is often not able to deal with, or communicate with, the end client in fact in many cases the agency above them in the supply chain expressly prohibits this communication.

The agency also often refuses to communicate any information.

Even if the fee payer could communicate with the agency and/or end client there is no compulsion for them to provide accurate or correct information. So, the fee payer would, yet again be wondering if the information provided was a true representation of the arrangements.

This leaves the fee payer working with the contractor to assess the status often without all the relevant facts.

The legislation is clear that worker statements alone will not protect the directors of the fee payer from liabilities being passed to them directly.

The combination of all these facts has resulted in the misclassification of many workers as those fee payers seeking to operate within the rules, and at a low risk, are unable to determine the status with any certainty so must operate the assignment as if it were caught by IR35.

2. Employment Status of Worker

The fee payer is required to make any contractor who operates through their own PSC, and is inside IR35, an employee of theirs. The classification of employee is 'for tax purposes only' and holds no traditional employment rights.

This added layer of employment seems to have come about purely because the current tax system cannot assign employers NI without their being an employer with an employee. As a result, and to ensure the full PAYE tax is collected the worker must become an employee of the fee payer.

Setting up the worker as an employee is the same detailed process as setting up any employee on a payroll including verifying confidential documents and the workers right to work in the UK.

Workers are already employees of their own limited company and so now have to have a BR or OT tax code allocated to this employment meaning the correct levels of tax will not be paid, in many cases tax will be over paid.

3. Invoice Settlement

Where a worker operating through their own PSC inside IR35 invoices the fee payer at the agreed rate the fee payer must pay employers NI on top on the invoice value, ex VAT, and then apply full PAYE to the net VAT invoice total.

The Fee Payer then submits an RTI return on the payments, pays PAYE and NI due to HMRC, transfers net funds to the PSC bank account but does not produce a payslip as they are not paying the worker.

This creates complexity in the accounting procedures as there is no transparency on full settlement of invoices. Journals typically have to be created to address this issue.

4. The 5% Allowance

Within IR35 there was always an allowance within the deemed payment calculation of 5% to cover the costs that come with operating a limited company, specifically accounting fees, insurances etc. This allowance was removed during the introduction of the legislation with HMRC stating 'Removal of the 5% allowance reflects the transfer of responsibility for making a decision about whether the rules apply and deducting and making the associated tax and NICs payments.' The 5% was never about the cost of assessment of IR35 on HMRC's website covering the deemed payment calculation it states: 'You then apply a flat rate 5% deduction from this income for general expenses you've incurred in running your business. You don't need to demonstrate this expenditure.'

We suggest the real reason the 5% allowance was removed relates to the speed at which the legislation was brought.

In meetings that PRISM attended it was clear that payroll software providers would require a minimum of 6 months to develop their payroll software to deal with the 5% allowance.

HMRC made it clear that they would be unable to provide 6 months' notice between the final legislation being published and implementation – so a simple choice:

1. Delay the legislation to allow payroll software to catch up – NO

2. Introduce the legislation without any payroll software able to support it – NO

3. Remove the 5% allowance so it all works with existing payroll software – YES

In simple terms, it appears that we now have computer software determining the shape of tax legislation in the UK.

5. Accounting

The accounting profession and book-keepers have been confused by the whole process.

Their clients send an invoice for say £2500 ex vat and receive, as an example, £1400 in full settlement.

There is not obligation on the fee payer to provide financial statements covering the £1,100 deductions and accountants are having to create journals to balance the books.

Further confusion exists around the fact that all the genuine running costs of the business must now be taken out of the net income of the worker.

Where contractors are using small firms, we do wonder whether the messages have filtered down to these companies and whether the accounts submitted at the company year-end will be aligned to the new rules.

6. Taking Income from The Company

The most common questions relate to pay, accounting procedures and payment of dividends.

HMRC guidance for workers states:

Salary

You can pay yourself for the work provided to public sector clients through your company's payroll. As employment taxes have already been paid on the amount your intermediary receives, you can pay yourself that amount without deducting Income Tax or NICs.

You can report non-taxable payments your company pays you on the Full Payment Submission (FPS) that your payroll software produces. If you use Basic PAYE Tools, you don't need to report these payments.

Secondary Class 1 NICs will be payable on earnings paid through your company's payroll on which you deduct primary Class 1 NICs.

Dividends

If you're a director of your own company, you might choose to pay yourself a dividend from the company's profits. You can pay yourself a tax-free dividend up to the total of the deemed direct payment received from contracts in the public sector, where Income Tax and NICs have been deducted at source. You don't need to declare that dividend on your Self-Assessment tax return.

As the guidance clearly shows a completely different set of reporting rules and requirements have had to be built to deal with the complexities of the off-payroll legislation.

Change is without doubt a complexity and to change many of the basic accounting principles for one piece of specific legislation seems to be fool hardy.

Recommendations

- As previously suggested, remove the employers NI threshold and reduce the headline rate.

- Reform the tax system to allow payment of 'Employers NI' without an associated employee. This should allow an employers NI payment to a company reference.

  This simple development of the tax system would remove all the complexity associated with the current set of rules.

It delivers minimum change in procedures and means that where a worker pays themselves through their own company there is a non-refundable credit of employers NI that can be used in relation to income taken from that assignment.

The company would invoice the fee payer and the fee payer would simply pay 13.8% of the net invoice total against the relevant company reference number for the scheme. The invoice would be settled in full to the company bank account.

There is no requirement for complex guidance on accounting and reporting, the complexity of the 5% allowance is removed and this could be re-instated, which moves the situation back to almost equal returns regardless of operating structure, the current system results in the lowest returns for workers in a PSC as a result of paying operating costs from net income.

The worker remains an employee of their PSC and holds one employment, removing the tax coding and reporting issues.

We believe that this delivers the right result with minimum change across the supply chain and therefore is likely to be more easily adopted and accounted for correctly.

We address the compliance implications and enforcement in the next 2 sections.

Compliance

The legislation, as it stands, has built in incentives and protections for both recruiters and workers to seek out providers offering, what we would consider, non-compliant solutions.

The structure of the arrangements means it is highly unlikely that HMRC will be able to collect any taxes due from the non-compliant providers and therefore the anticipated tax gains will be significantly reduced.

1. The Fee Payer

With the legislation putting all the liabilities for the deduction and payment of the relevant taxes on the fee payer we are seeing an increased number of arrangements that are clearly being established to disregard the rules.

A recruitment company can gain a commercial advantage, and protect their margins, where they are able to use a solution that delivers a higher return to their workers. These become particularly attractive where there is no risk of liabilities being passed back to them.

Workers also want to seek out solutions that deliver the highest returns on the money they receive from an assignment. The combination of these factors together with liabilities resting solely with the fee payer creates an outcome that effectively encourages parties to seek out non-compliant offerings knowing there is no risk to them.

The end users also benefit where these arrangements are used as they can obtain workers at reduced rates where the fee payer makes a wrong assessment.

Since this legislation was introduced we have seen a significant growth in the number of non-compliant offerings which, once again, are severely damaging the responsible providers who seek to apply the rules as intended.

2. The Assessment

Similar to the point above recruiters can gain a commercial advantage where a fee payer assesses an assignment as outside of IR35. It is the fee payer that holds the responsibility for carrying out the assessment. If they make an incorrect assessment resulting in additional taxes due it is the fee payer that holds this liability.

The arrangements being established are similar to those reported in The Guardian newspaper on the 10th July 2017, https://www.theguardian.com/business/2017/jul/10/tax-scheme-anderson-group, with a follow up article on 20th July 2017, https://www.theguardian.com/business/2017/jul/20/recruitment-sector-tax-scheme-anderson-group.

Providers offering outcomes that deliver higher returns to workers are particularly attractive where no liabilities pass to any other party, which is the case under this legislation.

Recommendation

- Amend the debt transfer rules.

  Having the fee payer solely liable clearly does not work and, as we have highlighted, creates an incentive for other parties to seek out non-compliant providers. We would suggest a requirement of due diligence being placed on recruiters to ensure the providers offering appears aligned to the legislation. Where non-compliance is found and HMRC are unable to recover monies from the provider, or the providers directors, then the losses relating to employers NI could be passed to the recruitment company. The recruitment company could appeal these by providing evidence on the due diligence carried out.

The TUC is calling on the government to pilot a joint and several liability approach to enforcement, so that employers are held responsible for compliance throughout their supply chain. [TUC]

End users should also be placed in the potential liability chain as they too benefit from reduced rates. In the case of end users, they should be provided with an appeal process where they are able to show due diligence had been carried out on the recruitment company processes for compliance in the supply chain.

As the worker is also benefitting from a reduced tax outcome they too should be within the potential debt transfer parties. Where the provider, or their directors, fail to cover the losses then at the same time as issuing a debt transfer notice to the recruitment company a notice could also be issued to the worker for their shortfall in PAYE, clearly this would exclude the employers NI element. A worker can be given a right of appeal where they can show that it was the recruitment company that advised they use this solution and in these cases the workers debt would then pass to the recruitment company, subject to their due diligence appeal.

Enforcement

1. Fee Payer

As we have already highlighted there are a growing number of fee payer arrangements that are unlikely to apply the rules as intended. These are structured in a way that allows them to cease the business at short notice which is likely to be triggered by the start of a HMRC enquiry.

The result is that compliant providers seeking to apply the rules as intended, and taking a long-term view of building their business, are the only ones that will suffer. They suffer commercially as fewer workers will opt to use them as greater returns can be achieved elsewhere and they suffer through enforcement as they will be the only ones there to pay for any mistakes they make.

2. Income Reporting

The complexity around how income is reported, or in the case of dividends not reported, means that there is an increased chance that misreporting will apply.

With the fee payer employing the worker for tax purposes only there seems to be increased complexity in joining the income and tax from the fee payer to any other reported income through the company.

This will result in an increased amount of resources required to trawl company accounts to ensure correct reporting has been carried out.

3. The Assessment

Ignoring the actual terms of the assessment as we cover this later and looking purely at a principles level then a critical aspect of the legislation is the accurate assessment of the status of an assignment.

Government should create an obligation on employment tribunals to consider the use of aggravated breach penalties and costs orders if an employer has already lost an employment status case on broadly comparable facts – punishing those employers who believe they can ignore the law. [Taylor Review]

HMRC still face the complexity of reviewing each individual assignment on a case by case basis and with the assessment legislation being complex and lacking certainty of outcomes this results in the following:

1. Misclassification of workers where a risk adverse approach is taken, i.e. workers that could be outside the rules are assessed as inside for fear of debts.

2. Misclassification of workers where a high-risk approach is taken, i.e. workers that should be inside the rules are assessed as outside and structures are in place to avoid any associated debts.

3. A correct assessment of status.

As we have already noted we have seen a significant increase in those operating within '2' and no visible action from HMRC to close these providers down.

In the modern business world where arrangements are openly marketed with no visible compliance activity this creates a 'perceived compliance'. This is further supported by the fact that the complexity of the legislation means that most people are unable to understand the offerings and are reassured by the perceived compliance. This is also often supported by expert legal opinions that, once again, most people are unable to understand but do take reassurance from them.

Enforcement, or more accurately visible enforcement, is a critical aspect of achieving a compliant, orderly market place.

Market distortions or areas of non-compliance must be acted upon quickly and where possible the information should be made public.

Recommendations

- As previously suggested, remove the employers NI threshold and reduce the headline rate.

- As previously suggested, reform the tax system to allow payment of 'Employers NI' without an associated employee. This should allow an employers NI payment to a company reference.

- As previously suggested, amend the debt transfer rules.

- As previously suggested, consider how the Intermediary Reporting could be enhanced to include assignment status.

- Compel all parties to provide accurate information to the next party in the chain. Where information is knowingly provided that is false then any liabilities should pass to the party that provided the misinformation.

- Consider a Financial Services style approach to enforcement.

  The current approach fails to differentiate between a provider who has a complete disregard of the rules and a provider seeking to apply them as intended but with some shortfalls of process.

  Within financial services there is a recognised difference between a firm seeking to apply the rules correctly and maybe having a few shortfalls that need tightening and a firm that has systemic failings. With so many of the rules across the market being complex with uncertain outcomes this approach recognises the responsible providers who are seeking to apply the rules as intended and takes a more collaborative approach to ensuring robust application of the rules.

- Ensure the name and shame principles are applied where any provider receives a penalty for systemic non-compliance.

- As part of a strategic review, and in line with the principle of simplification, a full review of existing legislation should be carried out to identify areas of duplication, complexity, and uncertain outcomes.

Whilst we have focussed specifically on the most recent piece of legislation for a detailed analysis to demonstrate that applying strategic thinking and vision can deliver better outcomes the same analysis could be made on almost all the legislation introduced to the sector over the last 10 years.

IR35

IR35 has, for many years, been the subject of much debate.

The Government asked the Office of Tax Simplification [OTS] to carry out a review as one of its first projects and part of a wider review of Small Business Tax. Whilst suggestions were made the legislation remained as was.

There have been some tweaks around the edges which, in the usual approach to legislation, were more to address perceived issues at that time as opposed to any strategic plan.

Whilst there are arguments that can be made for IR35 to remain, primarily around the legal case history that has been built up, we believe that the mere mention of IR35 sends shivers down the market. It has become toxic and negative and it is hard to see how this position can be changed.

If we review IR35 against our guiding principles of Simplicity, Compliance and Enforcement it is fair to reach a conclusion that it fails in all aspects, which is probably why it is viewed so negatively.

As the SMF highlight in their report even HM Treasury feels it is 'not working' and 'unlikely ever to work practically'.

Clarifying employment status would also provide an opportunity to reconsider the role of IR35, which in the view of the Treasury's expert advisory body is 'not working' and 'unlikely ever to work practically'. In doing so, the Government should look in depth at the characteristics of those who are on the boundary of employment and self-employment, including contractors and those working through intermediaries. [SMF]

For this reason, it is hard to comprehend why new legislation is being built around a framework of assessment that doesn't work.

Recommendations

- Government carries out a review of employment status as a matter of urgency with a view to achieving simplification, clarity and certainty of outcomes. This must incorporate the concept behind IR35 and distinguishing between a person genuinely in business on their own account and a disguised employee, to use common terms.

- Government stops any amendments, updates, or new legislation in this area until the review is completed.

The Way Forward

It would be possible to introduce special rules of thumb that help protect the individual or the taxpayer. International practice shows that these rules can apply to: the nature of work engaged, the length of time the worker is engaged, the value of the work, the value of the work as a proportion of the worker's annual earnings and the payment schedule. [SMF]

As everyone involved, including Government, concludes this is not a simple problem to solve.

We feel it is time that Government takes a fresh look at the legislation. Clearer legislation should improve the ability of citizens, and those who support them, to understand what employment status applies and what rights they are entitled to. While better guidance plays its part, legislation that reflects the reality of the modern workplace is a key driver and must be the starting point. This will ultimately filter down to individuals as Government and advisory bodies are able to deliver clearer guidance and advice. [Taylor]

By the wide-ranging views on how to solve there must be an acceptance that not everyone will agree with the final outcome, however everyone seems to agree that something needs to be done. Doing nothing is not an option.

..as suggested in the report 'Better Budgets' which we co-authored with the Institute for Fiscal Studies and Institute for Government, there is a better way of proceeding. Chapter 4 of our report10 sets out 10 steps which would help to achieve better budgets and tax policy making. However, the chapter starts by setting out a simple vision of: 'A Budget process that contains fewer measures that are better thought out – and can be implemented efficiently by HMRC without imposing unreasonable burdens on taxpayers.' We believe that this can be achieved by '[A] better public debate on the big tax choices – with politicians making informed decisions.' The aim being 'Greater stability in the areas of the tax system where taxpayers – individuals and business – need to make long-run decisions. A tax system that commands public support – and is robust enough to raise the money we need to finance the state we want.' [Chartered Institute of Taxation]

There are wide ranging proposals that have already been made through the reviews already published. These range from high level suggestions to specific definitions and recommendations.With the amount of time, energy and thought that has been put in to these considerations it would seem a complete waste if the Government just brushed it aside.

Changes to legislation will be a significant step in improving the employment law framework and making the law do the work rather than the courts. But Government must continue to consider ways in which it can embed the rights and responsibilities set out in legislation so that there can be less misunderstanding or opportunity for avoidance. [Taylor]

Recommendations

- Government sets up a panel, made up of the bodies that have published reviews on the subject, to create a framework for debate and consideration.

  This framework should be used to underpin the Government Review we are suggesting.

To provide certainty and sustainability, the Government should introduce a long-term plan setting out the sequencing of different reform measures. [SMF]

Equalisation of The Tax System

Once again this is an area that has been commented on, but few have failed to offer solutions.

With self-employment now comprising 15% of all employment, government departments, regulators and national statisticians must collect and analyse a much deeper evidence base as a starting point for more sustainable policy. [SMF]

What all seem to agree on is that the main difference in the tax system across the engagement models relates predominately to Employers National Insurance.

The imbalance between the tax burdens on employment and self-employment remains very large, mainly because of the 13.8 per cent cost of employers' national insurance (NIC) and, for the larger employers, 0.5 per cent Apprenticeship Levy which came in April 2017. This may be the biggest issue to be addressed if the tax system is to keep pace with evolving working practices. [CIOT]

Earlier in the report we made a recommendation to abolish the Employers NI threshold and reduce the headline rate of Employers NI payable. We believe that this change will help create a simpler base for other changes to be considered.

If it is concluded that entrepreneurialism is to be encouraged or rewarded in some way via the tax system, it would become necessary to distinguish between genuine entrepreneurialism and the kind of self-employment (whether undertaken through a company or not) which has been entered into simply to minimise taxation or because an 'employer' wishes to avoid liability to workplace benefits (and a liability to employers' NIC). (It would also be important that the proposed quantum of any such differentiation should be stated and justified and that the differentiation should be periodically reviewed, as good tax policy procedures would suggest.) [CIOT]

If the politics can be managed, self-employed NICs are easily resolved. The bigger challenge is Employer NICs. Levying these directly on workers, by increasing the individual's NIC by 13.8%, would be impractical. It would also be undesirable as the visibility of the tax would reduce work incentives. A more feasible proposition would be a "Hirers' NICs", with any organisation engaging labour playing a flat rate of NIC. [SMF]

Equalisation of The Tax System

The first question to pose is:

Where a worker is genuinely self-employed or genuinely running a business should they pay the same levels of tax as an employee?

We would suggest that the answer is no.

These individuals hold significant risks, have no guarantee of income and fall outside of many of the rights and benefits offered to employees, therefore any tax differences should reflect these risks and shortfalls.

For example, someone earning an average UK salary (around £28,000) would pay £2,095 in National Insurance if they were employed. But they would pay £159 less if they were self-employed. In addition, the employed person's employer would have to pay £2,409 in National Insurance on top of this. But the self-employed person does not face this charge. This means that for both the individual and their employer, they will pay less in tax/NICs if they are self-employed rather than employed. [Taylor]

The situation is clearly different where the worker is effectively an 'employee' in all but name and we agree that in these cases similar levels of tax should be paid.

The key point once again comes down to determining correctly the status of the worker.

As regards tax and national insurance costs imposed on the individual, whilst the tax system has imposed 'deemed employment status' on agency workers, incorporated-owner managers within the remit of IR35 and now off-payroll workers in the public sector, the fundamental issue to be addressed is whether there should be a tax differential between the (genuinely) self-employed worker and the worker who is employed. [Chartered Institute of Taxation]

The second question is:

Where a self-employed or owner-manager does pay the same levels of tax as an employee should they have the same rights and access to benefits?

Under the principle of 'fairness' the answer would appear to be yes.

One of the bones of contention with IR35 has always been that whilst the contractor is paying full PAYE on their income they do not have access to the range of benefits available to employees.

The Government should design a 'Self-employed Benefits Package'. This should provide Statutory Maternity Pay, contributory JSA and sick leave insurance to workers that save into a private pension scheme. This would be a quid pro quo, with a message from the Government: "If you look after yourself, we will help". Low paid workers could be covered without this requirement. [SMF]

The answer to this question, from a Government perspective, is critical as it will need to be known for the proposed review to take this in to consideration.

The Gig Economy

The issues that have been thrown up by the success of many gig economy firms are not new and have done nothing more than expose weaknesses and opportunities that have been inherent in the tax and employment framework for years. It is, we would suggest, the fact that by utilising modern technology firms are able to develop their businesses to a significant size in a relatively short time frame and it is this success that has drawn so much attention.

..the changes observed in the UK are established and long-term. While relatively new gig economy firms have become the focus of public and media attention, the challenges thrown up by the distinction between self-employment and employment are longstanding, and one government study has concluded that rather than focusing on the short-term drivers the growth is better seen as a 'continuation of an existing, pre-downturn trend'.[15] Gig working has been a characteristic of our labour market for a long time, across a wide range of sectors including public administration, education, social care and financial services, as well as the more obvious ones of construction and transport. [SMF]

Platform based working offers welcome opportunities for genuine two way flexibility and can provide opportunities for those who may not be able to work in more conventional ways. These should be protected while ensuring fairness for those who work through these platforms and those who compete with them. Worker (or 'Dependent Contractor' as we suggest renaming it) status should be maintained but we should be clearer about how to distinguish workers from those who are legitimately self-employed. [Taylor]

A key element in the design of status assessments is that they don't focus just on addressing gig economy firms and seek to ensure that a level playing field is achieved across all businesses within a sector.

Whilst Uber has become a major focus on the engagement of their workers how they do this is in line with most mini-cab firms that operate across the UK. If Uber have to classify their workers as 'workers' and not self-employed shouldn't other businesses in the same sector be placed in the same position? Without this levelling of the playing field Uber would be placed at a commercial disadvantage to all other firms providing similar services.

..it is not clear in today's 'gig economy', how easy it is to identify entrepreneurialism based on a legal definition, and it is important that any particular differentiation introduced should be properly justified both as to its shape and amount and should be subject to periodic review. [Chartered Institute of Taxation]

The same is true for the transport sector where there has been a significant move to engaging drivers as self-employed. Once a few firms made the move others have been forced to follow to compete in this low margin sector.

Enforcement

Below are a range of the comments from the recently published reports. All agree that enforcement is a critical step and a simplification of legislation will help the enforcement agencies to act in a more timely manner:

An effective enforcement system should not just target violations and exploitation at the fringes of the labour market. In order to effectively tackle exploitation there must be concerted action to prevent and respond to all breaches of employment rights. Allowing 'low-level' or 'accidental' breaches to routinely happen undermines standards of decent work and encourages an environment in which exploitation can thrive. [TUC]

The HMRC should make a virtue of visibility: pursuing more cases of non-compliance, and publicising how many firms and individuals have been pursued successfully and the value of the money recovered. [SMF]

Non-compliance is facilitated by the complexities and uncertainties that characterise employment law and practice. These uncertainties make enforcement simultaneously harder and more necessary. [SMF]

The new Director of Labour Market Enforcement should consider whether the remit of EAS should be extended to cover policing umbrella companies and other intermediaries in the supply chain. [Taylor]

It is important that enforcement agencies have adequate resources to fulfil their statutory obligations. The TUC has concerns that the financial resources and numbers of inspectors at the enforcement agencies are not sufficient to provide an effective enforcement route across the labour market. [TUC]

The TUC is calling for a review of the resources at the enforcement agencies' disposal and whether these are adequate to fulfil their obligations, particularly in light of the newly expanded remit of the GLAA. [TUC]

"Of course, this system only works if everyone plays by the same rules. The vast majority of employers do just that, treating their employees well and paying them fairly. However, too many still think they can get away with ignoring the rules, breaking the law, and taking advantage of hardworking men and women who want nothing more than an honest job." Rt Hon Sajid Javid's MP, introducing the government's response to the consultation on creating a Director of Labour Market Enforcement

A key factor in creating a high value and high skilled economy is to have a solid employment law framework1. To achieve this three conditions must be present:

- *A good understanding of employment rights,*
- *A strong enforcement system, and*
- *Better use of information. [Law Society]*

But we think that more innovative forms of enforcement could also help tackle insecurity. Making companies responsible for abuses of rights along their supply chains could change the incentives to employ people on insecure contracts. And an extension of licensing, where employers must meet a set of standards before operating within a sector, could help tackle some of the worst abuses of labour market rights. [TUC]

A weak, ineffective enforcement system leads to the exploitation of workers. Employers underpaying the national minimum wage rates results in more workers living on poverty wages, earning below legal minimum thresholds. [TUC]

Removing incentives, clarifying the legal framework and addressing unfair risk transfer to vulnerable workers are all important steps to ensuring fair and decent work. However, this will not have the necessary impact unless people are able to enforce their rights when things go wrong. [Taylor]

Government should make the enforcement process simpler for employees and workers by taking enforcement action against employers/engagers who do not pay employment tribunal awards without the employee/worker having to fill in extra forms or pay an extra fee and having to initiate additional court proceedings. [Taylor]

… enforcement bodies in the UK regularly use intelligence and risk-led approaches to intervention and ensuring the successful functioning of the UK labour market should be no different. The government must become more proactive in its response to strategic shifts in employment to ensure it is not left playing catch-up. [Taylor]

Bad employment practices do not only harm those on a low-income, many of whom are in a vulnerable position and feel unable to challenge their treatment. Responsible businesses are put at a competitive disadvantage if unscrupulous employers cannot be brought to account for undercutting employee rights. Without creating a robust and proactive enforcement system other employment law reforms will not have significant impact. [Law Society]

Enforcement

Greater certainty should also, all other things being equal, increase tax revenues for the Exchequer as non-compliance falls and enforcement becomes easier. [SMF]

PRISM believes that any enforcement must be underpinned by the following: Enforcement must be visible to serve as a deterrent to those that seek to exploit, or disregard the rules. To achieve this, and in the current complex environment, more resources will be required.

Enforcement agencies should be able to act as fast as modern businesses can; that way they have a chance of recovery as well as quickly stamping out non-compliant behaviours.

Liabilities for non-compliance must be constructed in a way that allows third party users of non-compliant services an appeal process where due diligence can be demonstrated. Without this market distortions will occur.

Name and Shame rules should be updated to allow the publicity of offenders, as well as details of the offence.

Where rules are complex, as they are currently, those making best endeavours to comply with the rules as intended should experience a collaborative approach over shortcomings to help them create more robust compliance.

On the other side companies that have systemic failings or show a complete disregard to the rules should experience the full force of enforcement.

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