



Law Society
of Scotland

Consultation Response

Off-payroll working rules from April 2020

May 2019



Introduction

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

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

Our Tax Law sub-committee welcomes the opportunity to consider and respond to HMRC's consultation: *Off-payroll working rules from April 2020*¹. We have the following comments to put forward for consideration.

General comments

The law of employment status is currently under review. Employment status can be one of three things for employment purposes (namely employed, self-employed or worker) but only one of two outcomes for tax purposes (employed or self-employed). We consider that this tension needs to be addressed and will not disappear by amending the IR35 rules.

A key issue for employers, whether in the public or private sector, is that determining employment status is not their field of expertise. Decisions to engage or recruit can be made across organisations with differing skillsets. Despite this issue, the new IR35 regulations for the public sector and for large and medium sized employers place an obligation on employers, which means that numerous people within organisations will be required to gain a comprehensive understanding of complicated legal and taxation concepts. For this legislation to work as it is intended, an immediate scale up and transfer of employer knowledge is required. Without a significant knowledge transfer, the new legislation, like its predecessor, has the potential to be breached more often than it is observed. An employer toolkit and clear education programme and support will be required to be in place well in advance of April 2020.

There is also real risk of incorrect or disputed status decisions being taken and disputes ensuing between engagers and personal service companies (PSCs). We consider that there is likely to be an inequality of arms between such parties and it is important that steps are taken to rectify any imbalance.

¹ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/783409/Off-payroll_working_rules_from_April_2020.pdf

The Check Employment Status for Tax (CEST) tool requires to be refined and extensively tested prior to April 2020 and be available publicly well in advance of the legislation taking effect so that businesses can ensure that they are compliant and review their existing arrangements.

The public sector and private sector work very differently and these rules do not fully address the significant difference in speed of decision-making and attitude to risk. Businesses facing the demands of a 24/7 global economy are likely to require to be able to react quickly to customer demands and engage services to meet that demand on a project-by-project basis. The proposed changes add additional bureaucracy to employers who may already be overloaded and does not take full account of the realities and demands of doing business in the private sector.

It will be important for HMRC to develop clear and publicly available un-redacted guidance on a sector basis to enable engagers, agencies and those operating via PSCs to understand clearly their obligations.

Consultation questions

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

In determining if a business is small using an existing test is useful but may result in anomalous results.

We understand that anti-avoidance regulations are to be introduced to prevent disaggregation of large businesses to discourage businesses from becoming small to exclude themselves from this regime. The drafting of this will require careful consideration.

The charity sector and those in receipt of grant income or donations will require careful consideration when applying the turnover test.

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

This looks ideal on paper but, in practical terms, is likely to be far from straightforward. It may create more issues than it solves where a decision is disputed. Classing someone as subject to payroll taxes and not

giving them the corresponding employment rights is likely to cause friction and difficulty in commercial relationships and ultimately, could lead to dispute.

At present, the CEST tool can provide an outcome that is undecided – if this continues under the new tool, we would expect that engagers are likely to err on the side of caution and apply payroll taxes. An off-payroll entity is likely to dispute this. If the off-payroll worker proves that the engager's decision was wrong, the off-payroll worker will have to amend their tax position but may struggle to correct their National Insurance contributions (NICs) position.

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

It may prove helpful in some cases but not others. This has the potential to cause significant delays in payments to contractors where there is a long labour supply chain. Where payment is significantly delayed, this may create hardship.

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

Widespread knowledge and understanding of tax law in general is poor. The current poor compliance with the existing IR35 legislation is an example of this. Ignorance of the law is not an excuse, but the reality is that many businesses are simply overwhelmed by the multiple obligations upon them under the wide range of business taxes. Large public limited companies can generally assess risk and allocate staff (and teams) to deal with these matters. Medium entities may only have one or two people who remotely understand the rules around this area and have limited or no budget to spend on professional advice to support them. Ironically, this legislation may create project workers specifically engaged to implement a project to deal with this area but that will take time for business to budget for this, carry out a review and implement the resultant actions.

Care needs to be taken in drafting the legislation to ensure smooth interaction with other legislation. For example, GDPR, including sensitive data obligations and data controller obligations.

Clarity around how this legislation takes priority over Construction Industry Scheme (CIS) requires widespread publicity. CIS has been operating for years, is fairly well understood and compliance is relatively good. Is HMRC going to write to all and notify registered contractors and sub-contractors of the change in legislation?

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

Longer labour supply chains do exist and should not be ignored. For example, in the oil and gas industry long supply chains are commonplace. Also, financial services, banking and the construction industry can have longer supply chains. National and international large companies may also put in place large labour supply chains where they are engaging labour across the UK for local sites or offices.

There may also be separation in the supply chain to ensure that no employment relationship can be argued to have been established.

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

The client may not ever know or try to find out who the fee payer is depending on the length of the chain. It is not clear how a client would be able to easily identify the fee-payer in a long supply chain without HMRC becoming more involved, for example by prescribing set forms of notification or creating a form of notification.

The existing CIS arrangements are considered to work relatively well by comparison to the IR35 rules; does HMRC propose to introduce an equivalent to gross payment status?

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

It is not clear how this is going to improve compliance with a regime that has had low compliance rates for a significant number of years.

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

See answer to question 5. This question is not directly relevant to us.

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

Agencies are not regulated so it is not clear how they can be relied upon to comply with this. Does HMRC propose to register agencies? Without some security or surety, it is not clear how this can operate in practice.

As noted above, we consider there is a likelihood of disputes ensuing and HMRC is stepping out at that stage. It is likely to prove challenging to resolve disputes easily which will have a knock on effect on compliance.

If parties take all reasonable care to institute arrangements properly and comply with their obligations, it would be disproportionate and unfair for there to be no defence to becoming liable for the failings of others in the supply chain. While the supply chain connects the parties, the parties in that chain cannot control the actions of other independent businesses in the same supply chain and on that basis, we consider that they should not be held liable for their actions.

There should be a clear view on which party is liable for the tax and who HMRC is entitled to pursue to meet that tax liability. All parties to the supply chain should be clear about their obligations and be on fair notice from the tax authorities as to what is expected of them.

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

NICs liabilities require careful consideration and any reclaim or adjustment of NICs in the case of wrong decision needs clear procedures.

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

There is a vulnerability in labour supply chains where entities in the chain disappear through insolvency leaving unpaid liabilities, which are then passed down the chain. This may have a serious impact on the financial viability of the entity liable for tax and NICs they had not budgeted or provided for and thought had been accounted for further up the supply chain.

Contractual terms cannot resolve this alone especially where an entity is dissolved or struck off the register at Companies House.

We consider that this is a disproportionate way to encourage compliance and may also create an uneven playing field in the sector.

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

There is a mis-match between the agency rules and the new proposed regime. Companies need to clearly understand their obligations. A defence of reasonable care needs to be incorporated so that where a business has taken all reasonable steps to comply where the liability is passing up a labour supply chain, they cannot be held liable.

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

It may and it may cause dispute, which causes burden on a client. Education and a sufficiently clear and long enough lead time for implementation of the new legislation is critical.

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

Whilst this keeps the dispute between the commercial parties, it ultimately links to a tax obligation. Without a formal appeals process, off payroll contractors will end up in breach of contract disputes to the extent that

they have provided appropriate obligations in the contracts. See above in general comments for further views on this matter.

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

Yes. Employment status is a vexed issue; the number of cases taken by HMRC demonstrate this.

This assumes that all companies already have the right level of knowledge and understanding which is not the case.

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

Business requires flexibility and agility to operate in the global economy. Business requires fair notice of what is required.

Any process needs to be bureaucracy light and clear. Penalties require to be proportionate and clear. A dispute and appeals process needs further consideration.

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

We consider this unlikely.

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

We consider that education is necessary and of great importance, both externally and internally in HMRC especially payroll inspectors and National Minimum Wage (NMW) assurance officers. Widespread knowledge and understanding is critical. There will be geographical and sectoral specific elements to factor

into this – one size will not fit all. We suggest that clear webinars and ‘how to’ videos for each step in the process; engager toolkits; updated education for employers, businesses, engagers, agencies and advisers will be critical.

Ongoing advice and support for employers, engagers and those engaged via PSCs requires to be available and not just via professional advisers.

Business requires and demands simplicity, flexibility and clarity in its obligations in respect of its labour supply chains to enable business to compete and survive in the global market and generate economic growth. The CEST tool is critical in this process and the new legislation and its compliance may stand or fall on the basis of how well the new CEST tool operates and whether it is as refined as possible.

For further information, please contact:

Alison McNab
Policy Team
Law Society of Scotland
DD: 0131 476 8109
AlisonMcNab@lawscot.org.uk