EMPLOYMENT INTERMEDIARIES AND TAX RELIEF FOR TRAVEL AND SUBSISTENCE

ICAEW welcomes the opportunity to comment on the consultation document *Employment intermediaries and tax relief for travel and subsistence* published by HMRC on 8 July 2015.

This response of 2 October 2015 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

On 20 August and 10 September 2015 we attended meetings with HMRC in which we were able to put forward some key comments and concerns and discuss aspects of the consultation document.

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ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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MAJOR POINTS

Key point summary

1. We understand why the government feels the need to act on travel & subsistence (T&S) expenses paid to workers supplied by intermediaries, but we question the need to act now, before other changes have had a chance to affect working practices. The 2016 change denying exemption for expenses paid through salary sacrifice schemes is likely on its own to cause major issues for umbrella intermediaries that will solve most of the perceived problem. The introduction of the dividend tax will also deal a major blow to the personal service company (PSC) model of doing business, at least at the volume end of the market. The proposed extra layer of change to T&S rules is very premature and unnecessary, adding complexity where none is proven to be needed.

2. Even if the proposals go ahead, we believe that they are, in their current form, misconceived, and will cause major collateral damage to many businesses not involved in tax avoidance who employ their staff through intermediaries for sound and longstanding commercial reasons. There is no justification whatsoever for denying T&S relief to group service companies and PSCs outside IR35. We were extremely surprised when this was confirmed to be a deliberate part of the plan in consultation meetings with HMRC, since this would simply be a major increase in tax and NIC liabilities where no avoidance was being countered. There will be potentially huge extra costs to business if they have to reorganise, either to move employees into the businesses in which they work (if indeed it is practicable – many work regularly in more than one group business, but it currently does not matter) or to gross up T&S costs so that employees are not out of pocket. An executive supplied by a group service company, earning enough to pay income tax at 45%, would pay around £5,000 for a return flight to New York, on which tax of £2,250 would be due. To ensure that he or she was not out of pocket, the company would have to pay around £4,250 to leave him or her with enough money to pay the tax and employee NICs and not be out of pocket. Taking into account the employer NICs, the company would in effect pay £10,000 for the flights on a genuine business trip. HMRC's own staff working for other government departments would also see their T&S expenses taxed. We do not believe that this is in any way what ministers were envisaging when the project was initiated.

3. The concurrent consultation into reforming IR35 to impose a liability to deduct on an engager, rather than a PSC or agency, explicitly excludes from its scope intermediary-type arrangements undertaken by businesses that are not labour providers: group service companies and professional practices supplying a number of staff members on secondment to clients would be excluded from the scope of the proposed changes. This is clearly sensible as they are not part of the problem that HMRC is allegedly seeking to solve. We cannot comprehend why this approach has not been adopted for these T&S proposals, which as framed will result in a grossly unjust set of rules that will affect many ordinary businesses very badly.

General comments

4. We are surprised that this review of T&S for workers employed through an employment intermediary and under the supervision, direction and control (SDC) of any person is being undertaken in isolation from the on-going wider review of travelling and subsistence. There are many employment status issues that need looking at in the round, as recommended by the Office of Tax Simplification (OTS) in its report last March. Dealing with issues piecemeal has a track record of adding complexity and simply making the problem reappear somewhere else. We therefore counsel that Government undertakes the review of travelling and subsistence as a coherent whole rather than decide on changes for intermediaries and work that result into the review of the whole framework.

5. The way to ensure compliance with any rules involving employment intermediaries is for HMRC to police them comprehensively. We therefore recommend that Government should

ensure that the Department is appropriately resourced and staff trained to undertake such work in a proportionate and fair manner.

RESPONSES TO SPECIFIC QUESTIONS

Question 1: Do you agree that the structure of the proposed legislative changes will achieve the policy objectives?

6. We are concerned that personal service companies will have one status test for IR35 (the general employment status test) and a different one for travelling expenses, with potentially quite large numbers of people being caught under one and not under the other (this could happen both ways). This will be very difficult for people to understand (including HMRC's Employer Compliance staff) and is an unnecessary complication.

7. The devil will be in the detail, and so it will be necessary to ensure that the rules and any guidance make it clear to everyone what they should do in any given situation.

8. We believe that the proposals far overshoot the policy objectives and are therefore grossly unfair. As drafted, and planned, the rules would deny a deduction or exemption for the travel expenses of those employed by a service company in any large organisation that centralises its payroll and HR functions in one group company but supplies its employees to work elsewhere in the group or in a consortium company. This is a perfectly normal, commercial structure unrelated to tax avoidance. We do not understand why the proposals in this context would ever be considered reasonable.

9. Similarly, not every PSC worker falls foul of the IR35 rules, or does not do so in respect of every contract. Many PSC workers are simply self-employed individuals seeking liability protection, and if they operated on a self-employed bass they would face no denial of relief. If a genuinely independent PSC worker happens to take on a short contract, as one incident in his professional career, it is not clear why this should in principle result in a denial of relief for travel costs. The group service company and the non-IR35 company are presumably not part of the problem that motivated the proposed change in the rules, so it is wrong that they should be caught by the change.

10. HMRC staff supplied to carry out duties for BIS on minimum wage compliance would also fall foul of the proposed new rules and would therefore have their travel and subsistence expenses taxed.

Question 2: Will there be any consequential difficulties in administrating each engagement as a separate employment?

11. Although treating each engagement as a separate employment sounds simple in theory, doing so in practice will create a compliance burden. This will be particularly the case in PSC situations where occasional contracts might be deemed to place the worker under SDC.

Question 3: Are there any particular professions who will be significantly affected by these proposals?

12. As outlined above, group service companies (eg, in large professional practices or corporate that as a matter of course employ everyone in the organisation under one company) and non-IR35 PSCs would be very adversely affected, without justification.

13. The proposals are clearly intended to destroy the business model of the umbrella company market and they should succeed in doing so, albeit with major collateral damage to other businesses not involved in tax and NIC avoidance.

Question 4: Will these changes result in a significant shift in the way those affected are employed? If so, what would this shift be and what would be the impact for the workers concerned?

14. Since group service companies and non-IR35 PSCs are used for good, commercial reasons, it is unlikely that the proposed change in the T&S rules would change how the workers are employed. However, there would be a major cost to the employers, who would have to gross up travel expenses payments. This could involve enormous sums and would clearly damage financially major corporate employers.

15. Umbrella employers who rely on taking a share of the tax and NIC savings to finance their business will find it difficult to continue. They seem likely to transfer the workers to agency contracts. There is a risk that some will resort to adventurous schemes in order to preserve their business, which will present HMRC with a different compliance burden.

Question 5: Would the definition of employment intermediary as proposed cause any practical difficulties? Please provide details and examples.

16. Yes – see above.

Question 6: Do you agree with the definition of the terms supervision, direction and control and will these definitions cause any practical or commercial difficulties? If so, what will these difficulties be?

17. The rules in section 44 ITEPA 2003 changed from 6 April 2013 to use supervision, direction and control (SDC) as key criteria. HMRC will recall that it took some time to draft guidance, now incorporated into the Employment Status Manual and the web guidance on the intermediary reporting rules. As we pointed out when we met, the guidance presents examples only in very black and white terms, so it is unlikely to be helpful in any cases near the borderline. We suggest that HMRC's compliance teams and employers need much more substantial and more nuanced guidance on the extent to which those terms are supposed to be understood in practice.

Question 7: Which option for a transfer of liability would work best to ensure future compliance, Option 1 or 2?

18. Transfer of liability Option 1 is unlikely to work, as the checks envisaged will not in practice be feasible, and would not necessarily feed through to the entity paying the worker's wages and expenses. The most likely result is that big engagers will expect agencies to do this where they are used, and they may be able to vet the umbrella companies for this, but audits of personal service companies (PSCs) are not a practical proposition because of the amount of work involved for relatively small sums of money. There may also be an increase in incorporations because of this (despite other steps currently subject to consultation and the introduction of the new dividend tax). Except where very big companies are involved we doubt that there will be sufficient understanding of the issue to get the right solution. It would also be grossly unfair to place the liability on the engager, where the engager has acted in good faith and provided any necessary checks and information, just because HMRC 'are unable to pursue the employment intermediary for any reason'. How would the liable engager know that HMRC had made genuine and adequate efforts to pursue the agency or umbrella company for the liability?

19. Option 2 is fairer, but the problem with it is that the engager has no contact with the employer umbrella company intermediary if there is an agency in the way. Unless there is an obligation upon all intermediaries in the chain to pass this information onto the one that pays the worker, then any information that the engager provides to the intermediary with whom the engager deals will not get passed to its destination. If any of the parties in the chain is offshore, there may be legal bars on the disclosure of information that cannot be circumvented by passing

more UK laws. HMRC should perhaps use the information gleaned to date from the intermediary reporting rules to establish how big the problem is.

20. Having made the agencies responsible for the operation of PAYE, and having done so on the basis that their business is the sourcing of labour, it is inappropriate to make the engager responsible; it is anomalous – and excessively complicated – to pass this liability by transfer of debt on to the engager. It more naturally sits with the agency, and we suggest that it sits there rather than with the engager except in cases where there is no agency. That would be complicated but less anomalous and more readily comprehensible.

21. None of the options deals with phoenixism, the solution to which is personal liability for all parties in the chain, although that would bring its own extra set of compliance problems.

22. The rules also need to cover what happens if one party provides false information to another. Statutory rules should override indemnities between the parties, and set out what role each party plays.

23. We suggest that consideration be given to expanding the quarterly intermediaries reports to cover whether SDC is being exercised and, if feasible in the context of the arrangements, to quantify travel and subsistence claims.

24. We believe strongly that the proposed rules are premature. The new rules exempting expenses that are not paid under a salary sacrifice arrangement, with effect from 6 April 2016, will result in umbrella intermediaries deducting PAYE and NICs from expenses, leaving the workers to make refund claims, assuming claims for travel between home and work are still possible after the concurrent review of T&S for all employees has changed the definition of allowable travel. The mere fact that workers will have to be paid under deduction of PAYE and NICs, reducing their take-home pay, should on its own mean that they desert umbrella employment in large numbers and, in all likelihood, put most of them out of business. The effects of the 2016 changes should be assessed before any further complications are added.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see via http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax).