WORKERS' SERVICES PROVIDED TO PUBLIC SECTOR THROUGH INTERMEDIARIES

DRAFT FINANCE BILL 2017 LEGISLATION: CLAUSE 1 & SCHEDULE 1

ICAEW welcomes the opportunity to comment on the draft Finance Bill 2017 legislation published by HMRC on 5 December 2016. A concurrent consultation on proposals for both the tax and NIC rules would perhaps have been more effective, and it is unfortunate that the NIC rules first exposed for comment on 26 January – ie just last week – differ from the income tax rules in a number of unnecessary ways. We shall comment on the draft NIC regulations separately.

This response of 1 February 2017 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.

We attended a meeting jointly with other bodies on 23 January hosted by HMRC and on 9 December 2016 the Reward & Employment Engagement Forum, which comprises professional bodies including ICAEW, payroll consultants and software houses, hosted a meeting with HMRC, in both of which meetings we discussed aspects of the draft legislation.

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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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THE MEASURE

Clause 1 and Schedule 1: Workers' services provided to public sector through intermediaries

The intermediaries legislation (Chapter 8, Part 2, ITEPA 2003, usually known as IR35) is to be reformed from 6 April 2017 by adding Chapter 10 for services provided to public sector bodies (PSB) by workers through their personal service companies (PSC). PSBs are referred to in the legislation as "public authorities" and PSCs as "intermediaries".

The measure:

- moves responsibility for deciding if the intermediaries legislation applies for engagements in the public sector from an individual worker's personal service company (PSC) to the public sector body (PSB), and
- makes the business closest in the payment chain to the PSC responsible for deducting and paying associated employment taxes and National Insurance contributions (NIC) to HMRC.

Where an individual works for the public sector through their own PSC and falls within the rules:

- the amount paid to the worker's PSC for the worker's services by the public sector end client, or, where there are intermediary organisations in a chain between the public sector body and the worker's PSC, the organisation nearest in the chain to the worker's PSC (known as the "fee payer" in the legislation) is deemed to be a payment of employment income (earnings for Class 1 NIC) for that worker,
- the fee payer, who is deemed to be the employer for tax purposes, is liable for secondary Class 1 NIC and must deduct tax and NIC from the payments they make to the PSC in respect of the services of the worker, send HMRC information about the payments using PAYE Real Time Information and remit payments of income tax and primary and secondary Class 1 NIC to HMRC,
- the public sector is defined using the definitions in the Freedom of Information Act 2000 and the Freedom of Information (Scotland) Acts,
  and
- the 5% allowance intended to be used by the worker's intermediary for certain business expenses is removed for those contracts with the public sector. This is intended to simplify administration and reflect the fact that PSCs no longer have responsibility for applying the rules. The worker's intermediary will still be able to claim business expenses that would be deductible or exempt if incurred by a direct employee of the end client, but not pension contributions or the expenses of running the PSC.

These changes also introduce a requirement for PSBs to provide information to agencies and workers about whether engagements are within the off-payroll rules.

PSBs will be responsible for determining whether or not the rules apply and will be required to share this information with agencies so the fee payer closest in the chain to the PSC which is paying the PSC can operate the rules.

The intermediary rules remain unchanged for the private sector, ie, compliance with the IR35 rules is a matter solely for the PSC and its director.

See draft legislation, a technical note, the summary of responses to the consultation to which we responded in ICAEW REP 127/16 (see our newsitem) and tax information and impact note TIIN published on 5 December 2016.

GENERAL COMMENTS

1 GENERAL COMMENTS ON THE MEASURE

The difficulty in distinguishing at times between employment and self-employment, the ability of some individuals to structure their affairs to receive the desired tax treatment, and the significant difference in employment rights and tax and NIC treatment of the employed and self-employed, have long run alongside a lack of clarity in tax/NIC policy and practical difficulties in identifying the "right" tax position.

The measure runs contrary to several of our *Ten Tenets for a Better Tax System* published in 1999 and summarized in Appendix 1, notably neither simple, easy to collect and calculate, nor properly targeted, nor constant, nor subject to proper consultation nor competitive (these are similar to the principles for tax policy established by the Treasury Committee in its report of 15 March 2011).

The draft legislation introduces complicated, retrospective measures to address problems arising from previous piecemeal attempts to counter perceived tax avoidance in the temporary employment sector . We wonder whether a real solution might have been found by taking a more holistic view and addressing the underlying cause. For example, we should welcome clarification of the government's policy rationale for charging different rates of NIC on earnings from employments and self-employments.

We understand that the measures will increase the cost of engaging consultants in the public sector, since government departments (who engage around 18,000 such consultants) are already advising them to increase their rates by around 20% to cover the extra costs so that they do not choose private sector contracts outside the new rules instead. It also seems likely that any such increase in public sector costs will exceed any extra tax and NIC revenue generated by denying the deduction of legitimate expenses.

Some of HMRC's policy assumptions in drafting the legislation appear to be wrong: the PSB or the agency will be obliged, for example to operate student loan deductions, because the student loan repayment rules piggy-back on the tax and NIC rules. Similarly, no provision is made for statutory payments by the PSC, which will have no income from which to make them, and a worker who will receive no earnings from the PSC that will enable him to qualify. Some of the thinking behind the drafting appears very muddled.

2. POLICYMAKING AND CONSULTATION TIMING

Our concern
We are concerned that much of the legislation will not work in practice. The meetings that HMRC held with stakeholders were welcome but too late in the consultation process.

Our recommendation
We urge the government to provide a detailed policy objective for the proposed changes so that consideration can be given to whether the draft legislation is the best method of achieving that objective or whether a targeted approach would better meet that objective.

Our concern
As noted above, we welcome the opportunity to help make the legislation better, but being asked to do this during the period leading up to the self assessment deadline means that many of our members who normally contribute to our representations are otherwise engaged in ensuring that their clients' tax returns are submitted on time and therefore they are unable to spend time on non-remunerated work.

Our recommendation

We suggest that personal including employment taxes consultations that extend over the 31 January self assessment deadline have response deadlines set in mid-February at the earliest, rather than, as in this case, 1 February.

SPECIFIC POINTS

1. COMMENCEMENT DATE (paras 10-12)

Our concern
The commencement date is too soon. Those affected are unlikely to be able to comply with all the new requirements by the start date of 6 April 2017 because, inter alia:

- The proposed law is convoluted and unclear and will not be final until Finance Act 2017 receives Royal Assent, probably in July 2017, over three months after the measure comes into effect.
- HMRC will be unable to finalise its guidance until after Royal Assent in July 2017.
- Parties in the chain will need to devise new hiring structures and negotiate new contracts.
- The draft NIC regulations take a slightly different approach to the tax proposals, adding complexity that cannot be accommodated into business processes by April 2017.

Para 11 is retrospective as if affects work carried out prior to the commencement date cited in para 10. For example, invoices for work to be undertaken in calendar month March are likely to be rendered and paid in April. Those contracts will have been drawn up in February at the latest, while many will have been written in mid-2016 or earlier.

Over-hasty and piecemeal implementation of new policy measures has characterised recent changes to employer taxes and processes and has seriously undermined respect for the tax system.

Our recommendation
We consider that the commencement date should be put back to 6 April 2018. This would give more time for all parties in the chain, software houses and HMRC to prepare to make sure the policy works as intended including HMRC being able to police compliance. It would also simplify the transition including the retrospection point.

Failing that, by early February 2017 we need:

- Final draft legislation for both tax and NICs which covers all the uncertainties listed below.
- Easy to understand guidance for workers and agencies and an updated Employment Status Manual for professionals and advisers.
- Technically proficient and responsive telephone support.
- The revised employment status indicator (ESI) tool must be up and running, having been thoroughly tested. It needs re-branding to convince people that it has been improved and it needs to give technically correct decisions in all cases. Users need to be able to print out Qs and As and ascertain the weighting that attaches to the various questions.

Our suggested amendments
Para 10, substitute “2018-19” for “2017-18”.

Para 11, substitute “2018” for “2017”.

Para 12, substitute 2018” for “2017”.

2. NATIONAL INSURANCE CONTRIBUTIONS (NIC)

Our concern

The absence of the draft NIC legislation until last week suggests that parallel NIC changes will not come into effect on the same day as the tax changes. Whilst not without precedent for recent changes to employment taxes, we consider that it is bad practice as it is inconsistent and confusing.

Our recommendation
As the draft NIC legislation has only just been published, we will send our comments separately. We would, however, welcome confirmation of a commencement date which is the same as the tax changes, in 2018.

3. INFORMATION TO BE PROVIDED BY CLIENTS AND CONSEQUENCES OF FAILURE (para 6, new s61S)

The measure
New S61S is intended to address the fact that agencies in the chain are not necessarily in a position to decide whether Chapter 10 applies or not. It requires the client, ie the public authority, to inform, in the contract or otherwise, the person who has entered into a contract with it whether or not they have "concluded" that Chapter 10 applies. If the information is not given, it gives the person who has entered into a contract with the client the right to ask the client this question and also the right to ask for reasons. If the client fails to reply on the main question (but not on the reasons) within 31 days then liability for accounting for PAYE income tax and NIC passes to it.

Our concerns and suggested solutions
S61S will not achieve its objective. There are a number of issues:

- The fee payer is still liable to account for the PAYE income tax and NIC, even if the public authority client has got it wrong – the public authority is not liable, even if it is negligent or makes a wrong decision. This appears inequitable and should be reconsidered.
- Although we understand that 31 days to respond is a fall-back as in most cases all parties will have agreed when entering into the contract whether s61M(1)(d) is satisfied, it is still far too long as many agencies will have been obliged to pay their contractors by the end of the second week of the engagement via the agency.
- There is no penalty for failing to reply to a request for the reasons for the public authority's Chapter 10 decision. This will mean that these reasons are rarely given, and so legal challenges are virtually inevitable, as dissatisfied contractors will have no other means of finding out what the reasons are. It should be specifically provided that any such dispute is under the jurisdiction of the tax tribunals, since a commercial court is unlikely to have the expertise to adjudicate in the fundamental matters of tax and NIC law that will underlie such a dispute.
- Ideally the fee-payer would obtain the information direct from the public authority. However, if there is another intermediary in the chain (which will be likely given the new provisions), then the fee payer does not have a right to request information from the public authority. We acknowledge that giving it that right may not in practice work in all cases; for example, when a public authority receives a request for information from a party that it does not know, there are obvious data protection issues, let alone the problem that the fee payer is unlikely to know who to ask in the public authority. The fee payers are likely therefore to get their information to decide on Chapter 10 exclusively from the workers, which is effectively the same as now and so will defeat the object of the exercise. Because of the complexity of modern business, it is entirely possible that the agency closest in the supply chain to a PSC will not know whether the worker is working for a PSB, three or four intermediaries further along the chain, so will not know whether or how to ask. It is equally possible that the worker may not know whether he/she is within the scope of Chapter 10, since his/her agency may contract only with a private sector business that happens to supply the PSC worker's services to a PSB, or to supply the worker's services as part of a

much larger composite supply of a service. The employment sector has been waiting for definitive guidance on the boundary between supplying personal service and supplying a service since the new agency rules were introduced in 2014: these proposals add to the pressing need for that definitive guidance.

- The worker does not have the right to require the public authority to give this information, even if he/she knows that his/her personal services are being supplied to it by his/her PSC. This will again encourage legal challenges for the same reason.
- There is no protection for workers and their PSCs from PSBs deciding to minimise their risk, whether or not a contract is caught, by opting for all contracts to be treated as Chapter 10 contracts, which then creates a PAYE obligation for the fee payer where none is justified and there is no right of appeal.
- There has been no satisfactory explanation as to why HMRC is not already enforcing liabilities under ITEPA 2003, ss 687 and 689, which would reduce the need for Chapter 10.

As drafted, this section looks incomplete, which (because of the presence of intermediaries in the chain between the fee payer and the client) will make the overall proposals completely unworkable.

Our recommendation

Regarding our first concern, we believe that it is absolutely essential that the PSB takes responsibility for ordering the intermediary to operate Chapter 10 if (a) the conditions in draft s. 61M apply and (b) the PSB is not the fee-payer. If the first intermediary is not the fee-payer either, then it needs to order the next in the chain to operate Chapter 10 as well, and so on. Anything less than this will certainly give rise to leakage which, considering the prevalence of intermediaries in this sector already, will soon become endemic.

As to the second and subsequent concerns, it should be compulsory for the information on whether s61M(1)(d) is satisfied to be passed directly to the worker and passed down the entire chain from the public authority to the worker when the contract is agreed or the work commences without having to be asked for. HMRC needs to supply a standard form to ensure that all the necessary particulars are provided.

We appreciate that if the chain includes intermediaries outside the UK then this may hinder enforcement of compliance by HMRC. We therefore suggest that where there are non-UK members of the chain, then the information requirement should pass direct between the two intermediaries which are immediately above and below the non-UK members of the chain in addition to including the non-UK members. There must be specific legislative authority for UK members of the chain to supply personal data to other UK members of the same chain, leapfrogging any intermediary outside UK jurisdiction. Without this, the information provisions will be unenforceable in many cases.

HMRC might want to consider more onerous sanctions for failure to reply, providing wrong information, etc, than are currently included in the draft legislation.

4. AMOUNTS CHARGEABLE TO AND ALLOWABLE FOR CORPORATION TAX ON TRADING PROFITS

Our concern

We are uncertain under what legislative provision the “fee payer” will receive tax relief for the deemed payment and the employer's NIC paid. Section 139 CTA 2009 allows a deduction for a deemed employment payment and related employer's NIC outside the public sector; however s 140A only allows a deduction for the deemed payment not for the NIC. We would have thought that the deduction for NIC would be under normal GAAP as an actual expense of whichever company paid it, but this raises the question as to why it is necessary to be explicit about the matter in s139. It would be helpful if either s140A is similarly specific about this deduction, or HRMC were to explain how the deduction for employer’s NIC is obtained.

We do not believe that the proposed s140A(2) CTA 2009 has the effect intended, and it may well lead to the paying intermediary not getting the tax deduction that it should. Suppose that it has invoiced £1,000 but only received £700 because of the deduction made by the fee-payer for NIC and PAYE, which it passes on to the worker. Its accounts will show income of £1,000, but it will have no deduction apart from this section, because the £700 is not an expense of the business in accounting terms (it is, in fact, under no obligation to pass this money on to the worker and may possibly not do). The section as drafted gives a deduction for the £700 but not for the £300 that has been deducted already. It needs to do so, and this can be effected by removing limb (b) from this subparagraph.

Our recommendation
For the avoidance of doubt, the first point (deduction for NIC) needs to be clarified. On the second point, limb (b) or the proposed s140A(2) CTA 2009 should be deleted.

5. TAX RELIEF FOR PENSION PAYMENTS AND CAPITAL ALLOWANCES and CALCULATION OF DEEMED DIRECT PAYMENT (para 6, new s61U(2)(c) and new s61Q) and

Our concern
There appears to be no ability to deduct pension payments or capital allowances where someone works for an entire year in the public sector under contracts within Chapter 10, as the PSC will have no profits to set them off against. It can be done under proposed s61U(2)(c) if the pension or capital equipment is paid for directly by the intermediary. However this will be very cumbersome to operate in practice and contractors are unlikely to realise the necessity of doing it, and many pension schemes will refuse to accept a payment made by a third party because of their own tax rules and money laundering rules. Agencies will not operate registered pension schemes for PSC workers, and the PSC will have no way of making employer pension contributions because it will have no profits.

Para 51 of the technical note published on 5 December says that statutory maternity/ paternity/ adoption etc pay, statutory redundancy pay, pensions auto-enrolment and pension contributions stem from the worker's PSC.

It is not clear under what law amounts of net deemed direct payments from which tax and NIC have been accounted for by the fee payer and which are passed onto the worker will count as pay which will be able to underpin claims to SMP/SPP/SAP and similar payments, statutory redundancy pay, national minimum/living wage, etc in the PSC.

The PSC will have no funds out of which to make such payments, and given that tax and NIC have already been deducted by the fee payer, will be unable to give the worker tax and NIC relief at source.

In addition the VAT position needs clarifying – ie whether tax and NIC be calculated on VAT exclusive amounts. It is also questionable whether the PSC's service should count as a taxable supply for VAT purposes, since it will receive no consideration: the fees charged will be treated for tax purposes as deemed remuneration of the worker. This needs clarifying, and if it is the case that VAT is chargeable on the full invoiced amount, this reinforces the point that it is this amount that will be subject to Corporation Tax (see section 4 above).

Our recommendation
There should be a facility for the PSC to reduce the deemed payment by any such amounts paid/claimed, with whatever consequences may be appropriate for the contractor's own tax and NIC, by giving notice to the fee-payer.

Rights and obligations in respect of statutory payments, redundancy pay, national minimum wage, auto-enrolment, etc should be based on the deemed direct payments made by the fee payer and should attach to that organisation and the PSC should be exempted, in particular from auto-

enrolment obligations. This should be codified in the law. The published guidance in relation to student loan deductions also appears to show a lack of understanding of the Education (Student Loans) (Repayment) Regulations 2009: Chapter 10 and the NIC regulations will deem the fee-payer to be paying earnings for PAYE and Class 1 NIC purposes, and the liability to deduct and account for student loan repayments falls on the person paying earnings (Reg 41 of the Education etc Regs 2009). The PSB or the agency will therefore be responsible for the collection of student loan repayments; it will not be a self-assessment matter.

6. TAX RELIEF FOR VALID EXPENSES

Our concern
Workers in PSC companies will incur perfectly valid expenses and, because they are recognised as valid by the PSB, will be allowed to invoice for them along with their fees. The draft legislation gives no relief, requiring 100% of the fees to be processed through PAYE, with the sole exception of "materials". For example, a worker on a six-month IT contract might be required to attend a meeting in London to plan or discuss implementation. He might incur train and hotel expenses of, say, £300, which he is legitimately entitled to reclaim from the client.

As he will not be on the client payroll or in the client HR system, he is unlikely to be able to claim reimbursement through the PSB's expense system. His costs will be additional contract costs and will be added to his invoices.

It is grossly unfair that such expenses should be treated as his earnings for PAYE and NIC purposes. He will be entitled to claim tax relief using a P87 or self-assessment, many months after the event, but the NIC costs incurred by the worker and the PSB are irrecoverable but should never have been incurred in the first place.

Our recommendation
To ensure fairness and comparability between employees and Chapter 10 contractors, the amount of the deemed earnings must exclude not only materials but also reimbursement of any expenses that would have been exempt or deductible if paid to an employee of the PSB.

7. COMPANY OFFICERS: AUDITORS (para 6, new s61M(1)(d)(ii))

Our concern
Under company law auditors are officers of the enterprises that they audit. This is a longstanding anomaly given that, unlike other company officers such as directors and the company secretary, auditors must be independent of and not work for companies that they audit. IR35 is therefore not applicable in such circumstances, and Chapter 10 ought to work in the same way.

Our recommendation
New s61M needs to incorporate an exception for auditors.

8. PUBLIC AUTHORITIES (para 6, new s61L)

Our concern
Although many public authorities are obvious, some are obscure and can easily be confused with private sector equivalents (eg hospitals and nurseries). Also not all public bodies are subject to the Freedom of Information Act – one that apparently is not on the basis of the list in the consultation document is Companies House.

It is also crucial that there is a clear distinction between what counts as work for a public authority and what counts as work for a supplier to a public authority. Otherwise there will be endless disputes as to whether Chapter 8 applies, with the PSC being liable to deduct tax, or Chapter 10,

with the fee-payer doing so. It is not difficult to envisage a situation where both such companies deny responsibility and seek to pin it on the other, with consequential difficulties for HMRC in enforcing this legislation.

Our recommendation

There needs to be publicly-available list of public authorities on gov.uk which is kept up-to-date (in the same way as List 3). It would be advantageous also if this list were to give details of to whom to apply in the public authority for the client's conclusions under the proposed s61S ITEPA. This would make it much easier to obtain answers, and to track correspondence where s61S(5) comes into play to transfer liability to the public sector body.

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 http://www.icaew.com/-/media/corporate/files/technical/tax/tax-news/taxguides/taxguide-0499.ashx).