

## TAXREP 77/08

### TAX RELIEF FOR TRAVELLING EXPENSES: TEMPORARY WORKERS AND OVERARCHING EMPLOYMENT CONTRACTS

*Memorandum submitted in October 2008 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a consultation document published on 21 July 2008 by HM Treasury and HMRC*

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The Tax Faculty of the Institute of Chartered Accountants in England and Wales

TAXREP 77/08

Tax relief for travelling expenses: temporary workers and overarching employment contracts

# **TAX RELIEF FOR TRAVELLING EXPENSES: TEMPORARY WORKERS AND OVERARCHING EMPLOYMENT CONTRACTS**

## **INTRODUCTION**

1. We welcome the opportunity to comment on the consultation document published on 21 July 2008 by HM Treasury and HM Revenue & Customs at [http://www.hm-treasury.gov.uk/consultations\\_and\\_legislation/travel\\_expenses/consult\\_travel\\_expenses.cfm](http://www.hm-treasury.gov.uk/consultations_and_legislation/travel_expenses/consult_travel_expenses.cfm).
2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Annex A. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Annex B.

## **KEY POINT SUMMARY**

3. We consider that changing the law is likely to have unintended consequences, and that the Government can achieve its aims by using existing law and by HMRC tightening up compliance.
4. Any attempt to legislate in this area would merely replace one set of anomalies with another and would probably be open to circumvention. It may also impact on unintended innocent targets such as professional firms who employ staff through service companies, outsourcing businesses and employers with staff on secondment.
5. The consultation document suggests that the problem is caused by agencies and umbrella businesses using over-arching contracts of employment. We believe that in a number of cases the nature of the contract (as an over-arching contract of employment) could be open to challenge. Where they are employment contracts, it may well be because the companies using them are effectively no longer agencies or umbrellas, despite describing themselves as such, but more properly described as outsourcing contractors.
6. We also suggest that improvements in the way that HMRC polices the grant and operation of dispensations could resolve much of the concern. HMRC has to be satisfied that no tax will be due on the expenses paid before it grants a dispensation, and it has the power to revoke the same. It could attach conditions to dispensations, such as we propose below, which we do not think would be onerous. Certainly they would be less onerous than compiling forms P11D.

## **COMMENTS**

7. In the July 2008 consultation document, HMRC identifies two quite different problems which both lead to two particular types of company claiming more in the way of tax-free travelling expenses for their staff than intended by HMRC. The first is a compliance problem, and the second is a legislative problem. We believe that they merit different solutions.

### ***The legislative problem***

8. In essence, the problem is that the law unintentionally permits employment agencies and umbrella companies that use over-arching contracts of employment to treat (in many instances) their employees' places of work as temporary under section 339 of the Income Taxes (Earnings and Pensions) Act 2003 ('ITEPA'). This enables them to pay travelling expenses to those places of work free of tax (and NIC). If they were instead using a typical agency contract, the temporary (or otherwise) nature of the place of work would be decided on an assignment-by-assignment basis, and where all the work for one of their clients is done in one place, the cost of getting there could not be paid tax-free.
9. We oppose any changes in the law here. The consultation document draws attention to anomalies that undoubtedly exist, but as long as some people are allowed their expenses of travel to work tax-free, while others are not, there will be anomalies wherever the line is drawn. There is clearly a case for some workers to obtain tax relief for travel to work, and hence absolute removal of the distinction is not possible. In an environment of flexible working where business models mutate quickly for economic reasons, and where superficially similar businesses frequently follow different contractual models, it will not be difficult for businesses' models to mutate into something different for fiscal reasons. Any attempt to draw a legislative line will simply lead to people circumventing it. Since there is longstanding acceptance of the principle that the costs of travelling to a temporary workplace should be deductible (and the issues were discussed at length before the FA 1998 reforms), one of the bigger anomalies would seem to be that agency workers who have a series of temporary workplaces are not entitled to deduct their travel expenses unless they sign a contract of employment with the agency or one of its umbrella suppliers.
10. In describing the types of intermediary that operate in the temporary and contract labour market, we feel that it helps to draw attention to another kind besides employment agencies and umbrellas. An 'outsourcing contractor' takes on parts of its clients' businesses and provides staff *and management* to perform the functions contained therein. Unlike an agency it does control the workers and specifies what they do, subject to agreement with its clients.
11. These definitions (of agency, umbrella and outsourcing contractor) are essentially economic ones and they do not easily translate into law. In legal terms, what umbrella businesses and agencies do is essentially the same, as witness the fact that there are three different definitions of an agency:
  - the definition in the Employment Agencies Act 1973, which governs how they behave;
  - the definition in ss 44-47, ITEPA 2003, which governs what income tax they pay; and
  - the definition in Schedule 1 to the Social Security (Categorisation of Earners) Regulations 1978 (SI 1978/1689), which governs what National Insurance contributions they pay.

Although all three are worded differently, they can, depending on the contracts in each case, cover employment agencies and umbrella companies, but not normally outsourcing contractors. There is a separate essential difference between an agency and an umbrella business, namely who is generating the business. However, in cases where only one of them is involved it is sometimes hard to see any real difference in their functions. At its most basic, an umbrella company is an

outsourced PAYE service, performing a function that many agencies also perform as part of the wider economic role that they undertake. The two nevertheless view themselves as fulfilling completely different purposes and are keen not to be associated with each other.

12. Not surprisingly, there are examples of one form mutating into another. Common in the retail field is a practice whereby a supermarket will ask a single agency for a certain number of staff on a certain day (say 12 staff on a Monday morning). It will ask a single agency so as to be sure that it gets exactly the right number. If there are umbrella companies with the capability of sourcing those staff the agency will begin the process by asking them – this is simply the easiest place to go. The umbrella is thus beginning to fulfil the functions of another agency, even though it will still call itself, and consider itself, an umbrella.
13. Likewise, an agency may get to the point where it is effectively providing not only all the staff for a client's department, but the junior management as well, and it is perhaps economically sensible for the agency to take responsibility for the work done. It is effectively now an outsourcing contractor, even though it will still call itself, and consider itself, to be an agency. An example of this is commonly found in the hotel cleaning industry, where night cleaning is a service provided by the contractor who provides not only the cleaners but also someone to supervise them, and day cleaning is done by workers supplied by the same company, this time in the guise of an agency, with the workers working under the client's control, ie supervised by the hotel's own staff. The workers are doing what is to all intents and purposes the same work and are very often the same people: there is no obvious reason why their travelling expenses, doing the same thing for the same end users in the same places, should be treated differently for tax.
14. Finally, if any legislation is introduced to bring in a different regime for agencies and umbrellas, we urge that care is taken to ensure that it does not inadvertently cover cases of secondment and other unintended targets such as professional partnerships that employ staff via service companies. It is likely that, once the intended targets have mutated into something else, changing the travel relief rules may well not succeed in depriving the intended targets' workers of the entitlement to claim relief for travel expenses.
15. In short, any attempt to legislate in this area would merely replace one set of anomalies with another and would probably be easily circumvented.
16. By contrast, we believe that HMRC could achieve some of its aims using existing law. The consultation document suggests that the problem is caused by agencies and umbrellas using over-arching contracts of employment, but we would suggest that the problem is caused mainly by abuse or ignorance of the travel rules. Furthermore, in some cases the nature of the contract (as an over-arching contract of employment) could be open to challenge. Where they are employment contracts, it may well be because the companies using them are effectively no longer agencies or umbrellas, despite describing themselves as such, but more properly described as outsourcing contractors. HMRC's Employment Status Manual (at [ESM2002](#)) would appear to support this contention.

### ***The compliance problem***

17. The compliance problem is essentially that vastly inflated expenses are incorrectly paid free of tax, often using (or misusing) dispensations granted by HMRC. The solution proposed in the consultation document is to introduce transfer of debt provisions similar to those in respect of managed service companies (MSCs) brought in last year.
18. We believe that this solution would cause serious problems. The transfer of debt provisions were brought in to deter businesses from being managed service companies. In this they have been startlingly successful.
19. Managed service companies served no purpose beyond that served by umbrellas other than to avoid tax, whereas agencies perform a vital service in a flexible working economy (and one that the Government has gone out of its way to acknowledge). Umbrellas avoid a large amount of PAYE administration (both in their client companies and in HMRC) by reducing the number of recorded job changes of people who change their roles frequently. Whilst client companies remain reluctant to take workers on to their books and insist on their providing services through companies, they also perform a necessary function in providing those companies at a fraction of the cost of a personal service company. If this is considered undesirable then that problem should be tackled at its roots rather than obliquely through tax legislation.
20. Transfer of debt provisions for agencies and umbrellas may well have the same effect as they did for MSCs, that is to close down or greatly reduce an industry sector completely, at the same time driving businesses on very tight margins into aggressive offshore avoidance schemes. It would also be inherently unfair. The same difficulties of definition as described above would arise again and it would be the larger and cleverer companies that would be able to circumvent them. It might well be mainly smaller companies whose owners and directors did not have access to sophisticated tax planning who would actually suffer, particularly in a recession. Agencies are frequently thinly capitalised companies as they have low barriers to entry and find it easy to get their debt factored (it is very attractive as security to banks), and one large bad debt can cause them to be insolvent. It would be unfair, and be seen to be unfair, if HMRC were to pursue their owners for unpaid PAYE and NIC if the failure to pay were caused by an experience like this, yet it is hard to see how to legislate with clarity and certainty to transfer the debt in cases of insolvency through evasion, whilst not in cases of insolvency through bad luck.
21. Once again, though, we believe that there is much that HMRC can do in the way of tightening up the compliance regime, particularly where dispensations are concerned. As HMRC has to be 'satisfied' under s 65, ITEPA 2003 before granting a dispensation and can revoke a dispensation if in its opinion there is reason to do so, HMRC can attach conditions to it.
22. We suggest the following (which could apply to any dispensation requests, not just those coming from umbrellas and agencies):
  - Companies applying for a dispensation should be required to state either the maximum number of employees or the maximum size payroll that they expect, or both. This would enable HMRC to put the right grade of officer on to the case who would then ask the right questions of and risk-assess appropriately the employer seeking the dispensation.

- It should be a condition of the dispensation that HMRC be informed as soon as these levels are exceeded, and grounds for revocation if this is not done.
- Companies with dispensations should be asked – again as a condition of the dispensation – to file a brief annual report by the same date that forms P11D are due (possibly as an extra box on the P11D(b)), either confirming that the amount of expenses paid and covered by the dispensation is less than a certain percentage of the gross payroll or a fixed sum set by the officer granting the dispensation after having made appropriate inquiries, or stating the amount of expenses covered. This would give HMRC the wherewithal to direct its investigations towards companies considered at risk of being non-compliant.
- HMRC could specify which workers dispensations apply to.
- HMRC should also put in place systems to identify companies showing fast-increasing monthly payments of PAYE to the Accounts Office, again as a means of identifying risk in this field.

23. We believe that, because dispensations are conditional on HMRC being satisfied, taxpaying businesses could not reasonably object to these measures and that they would not be onerous. They would certainly be far less onerous than compiling forms P11D.

#### **ANSWERS TO QUESTIONS POSED IN THE CONSULTATION DOCUMENT**

24. Our answers to the questions posed in the consultation document are in Annex C.

PCB  
14.10.08

## ICAEW AND THE TAX FACULTY: WHO WE ARE

1. The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department for Business, Enterprise and Regulatory Reform through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.
3. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 10,000 members of the ICAEW who pay an additional subscription.
4. To find out more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at [taxfac@icaew.com](mailto:taxfac@icaew.com) or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.



## THE 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.co.uk/index.cfm?route=128518>.



## ANNEX C

### ANSWERS TO QUESTIONS POSED IN THE CONSULTATION DOCUMENT

#### Chapter 4 The use of umbrella companies

*a) What influences workers to use umbrella companies? How significant are these factors in relation to each other? Why do workers choose umbrella companies over alternative options?*

It is the nature of the current labour market. End clients (to use the term in the consultation document) do not want to have work carried out for them by people who may be deemed to be employees because of all the regulation that having employees entails. This is particularly so when the work is more akin to a project. People who wish personally to provide services in certain sectors therefore have to seek work other than as individuals. Insofar as an end user is concerned, using the services of a worker via a company is intended to remove the risk, both to the end client and to the worker, that the individual carrying out the work will be classified as an employee. Umbrella companies and the like find work for workers and take on the administration. This in turn also saves the worker the administration needed to run his own company and avoids the need to change employment with every assignment. Umbrella businesses sometimes have arrangements with agencies for finding work for their employees, so employees have a steadier job than they would have if they used only an agency while end users can rely on a readily available pool of temporary workers without taking on the legal obligations of being the employer and the paperwork associated with numerous joiners and leavers.

*b) What is your view of the Government's assessment of the number of umbrella companies and workers using them? If your assessment is different, on what basis have you reached your conclusions?*

We are not in a position to provide or check these figures.

#### Chapter 5 Employment agencies and overarching employment contracts

*a) What influences employment agencies to use overarching employment contracts?*

*b) How prevalent is the use of overarching employment contracts in the agency sector (number of agencies and number of workers)? How prevalent is the use of these contracts by smaller employment agencies? On what basis have you reached your conclusions?*

*c) Has the use of overarching employment contracts increased recently and do you expect it to grow?*

Employment agencies that offer employment contracts instead of contracts for services are more attractive to workers as they are likely to provide a steadier flow of work. Workers also know that they benefit from the temporary workplace rule on the tax deductibility of travel and subsistence expenses because they have the equivalent of a permanent job.

As noted in para 16 above, in some cases the nature of the contract (as an overarching contract of employment) could be open to challenge.

We are not able to quantify the number of overarching employment contracts in use, although it is clear there was a major increase after the closure of all the managed service company providers in 2007, when many temporary workers were offered contracts with umbrella businesses as an alternative to unemployment. It is difficult to foresee whether there will be any growth in the numbers, although a recession that produces more unemployed workers might conceivably lead to a growth in the number of people doing temporary work.

## **Chapter 6 Potential problems with overarching employment contracts**

*a) What is the extent of the problems outlined?  
b) Are there any further problems?  
c) What is the extent of non-compliance with the travel expenses rules?  
d) What factors are contributing to the abuse of the travel expenses rules?  
What practical measures could be taken to address this?  
It would be helpful to know the basis on which you have reached your conclusions in relation to all of these questions.*

We believe that in a number of cases the nature of the contract (as an over-arching contract of employment) could be open to challenge. Where employment status is an issue, it is one that should be looked at at the time that requests for dispensations are considered; if HMRC is not satisfied that the requesting business's contract is a contract of employment and considers that travelling expenses should be treated as for agencies then they should say so and make this clear in the terms of the dispensation.

## **Chapter 7 Action to address the problems identified**

*a) How well would each option address the problems highlighted in chapter 6?  
b) What effect would each option have on:  
a. The temporary labour market?  
b. End clients?  
c. Employment agencies?  
d. Umbrella companies?  
e. Workers?  
You might consider such aspects as the impact on costs for businesses, rates paid for temporary labour, and what alternative structures might be used.*

As noted above in paras 17-20, the transfer of debt provisions proposal would probably have the same effect as the MSC legislation. It would discourage people from entering or remaining in the target sector and may well cause it to shrink dramatically; it may also drive contractors into aggressive offshore schemes that would be difficult to police rather than remain in PAYE employment. However, this would militate against the Government's objective of having a flexible labour market and the companies which are the intended target are likely quickly to mutate into something else along with the associated abuses. We particularly question this proposal at a time when economic recession is looming.

As noted in para 14 above, the proposal to change the entitlement to tax relief for travel expenses would hit unintended targets. These would include professional firms and others who employ staff via separate companies and send staff on secondment (including possibly to some Government departments). It is likely that

once the intended targets have mutated into something else, changing the travel relief rules may well not deprive the intended targets' workers of the entitlement to claim relief for travel expenses.

*c) Are there any alternative courses of action the Government could take?*

As noted above in para 21, we suggest that policing the grant and operation of dispensations properly would resolve much of the problem. HMRC has to be satisfied before granting a dispensation and has the power to revoke it if there is reason to do so. It could attach conditions to dispensations. The conditions which we propose below are not onerous and would certainly be less so than compiling forms P11D, viz:

- Companies applying for a dispensation should be required to state either the maximum number of employees or the maximum size payroll that they expect, or both. This would enable HMRC to put the right grade of officer on to the case who would then ask the right questions of and risk-assess appropriately the employer seeking the dispensation.
- It should be a condition of the dispensation that HMRC be informed as soon as these levels are exceeded, and grounds for revocation if this is not done.
- Companies with dispensations should be asked – again as a condition of the dispensation – to file a brief annual report by the same date that forms P11D are due (possibly as an extra box on the P11D(b)), either confirming that the amount of expenses paid and covered by the dispensation is less than a certain percentage of the gross payroll or a fixed sum set by the officer granting the dispensation after having made appropriate inquiries, or stating the amount of expenses covered. This would give HMRC the wherewithal to direct its investigations towards companies considered at risk of being non-compliant.
- HMRC could specify which workers dispensations apply to.
- HMRC should also put in place systems to identify companies showing fast-increasing monthly payments of PAYE to the Accounts Office, again as a means of identifying risk in this field.