

TAXREP 24/06

Tax Faculty

VAT: HIRE OF STAFF BY EMPLOYMENT BUREAUX

Memorandum submitted in September 2006 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales to HM Revenue & Customs (HMRC) in response to an invitation to contribute to a review of the staff hire concession set out in Part A of the Statement of Practice contained in HMRC Notice 700/34.

CONTENTS

	Paragraph
INTRODUCTION	1-2
KEY POINT SUMMARY	3
GENERAL COMMENTS	4-14
WHO WE ARE	Annex A
TEN TENETS FOR A BETTER TAX SYSTEM	B

Tax Representation

VAT: HIRE OF STAFF BY EMPLOYMENT BUREAUX

INTRODUCTION

1. We are pleased to contribute to the review of the staff hire concession for employment businesses following the invitation contained in Business Brief 06/06 issued on 9 June 2006. The Business Brief can be found at the following link:

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_GuidesAndBusinessBriefs&propertyType=document&columns=1&id=HMCE_PROD1_025580

2. Details about the Tax Faculty and the Institute of Chartered Accountants in England and Wales are set out in Annex A. Our ten tenets for a better tax system are attached as Annex B. These are the benchmarks against which we measure the effectiveness of tax systems.

KEY POINT SUMMARY

3. In brief:
 - The impact of The Conduct of Employment Agencies and Employment Businesses Regulations 2003 will mean that employment bureaux will act as 'employment businesses' when providing temporary staff and will not be able to act as agents of the hirer/client in doing so.
 - If the concession is abolished and if VAT becomes chargeable on the full amount charged to the client/hirer including remuneration and National Insurance and pension contributions a substantial additional burden will fall on partly exempt hirers. For them it will be a new tax on employing temporary staff.
 - We recommend that HMRC should seek legal advice on what is the consideration for the supply of temporary staff employed by an employment business acting as principal and charging a commission based on the temporary employee's remuneration.

GENERAL COMMENTS

4. We assume that the review being carried out relates only to the VAT treatment of the hire of temporary staff by employment businesses and the concession set out in paragraph A of the statement of practice in Notice 700/34.
5. The effect of the implementation of the Conduct of Employment Agencies and Employment Business Regulations 2003 and of Regulation 8 in particular which

Tax Representation

came into force on 6 July 2004 is that with certain exceptions it is not possible for an employment bureau to provide temporary staff otherwise than on the basis of an 'employment business.' That results in the employment bureau having either an employment contract with the temporary worker or a contract for services. It is not possible to operate on an agency basis whereby the bureau is simply an agent of the hirer/client.

6. The Department of Trade and Industry's publication 'Guidance on the conduct of employment agencies and employment businesses' contains the following extract:

Regulation 8: – Restrictions on paying work-seekers' remuneration

Regulation 8 is designed to prevent agencies from directly or indirectly paying work-seekers on behalf of the hirer to whom the work-seeker has been introduced. Regulation 8(1) provides that an employment agency (as opposed to an employment business), which has provided a hirer with a work-seeker, may not pay or make arrangements to pay that work-seeker either directly or via any person connected with it. The purpose of this regulation is to prohibit employment agencies supplying temporary workers.

This used to be particularly popular when supplying temporary workers to hirers who could not reclaim their VAT such as hospitals, schools and in some cases individuals (such as the supply of temporary care workers into people's own homes) and the financial sector. In these cases it was common for an employment agency to introduce the work-seeker to the hirer on a temporary basis so that the work-seeker had a contract directly with the hirer rather than the employment agency. The employment agency would nevertheless settle the payroll on behalf of the hirer. The work-seeker's services did not, therefore, form part of the employment agency's service to the hirer. Therefore, when the employment agency charged the hirer, it only charged VAT on its margin, thereby significantly reducing its VAT charge to hirers who could not reclaim it. The Government however disliked this route because it was unclear from the work-seeker's point of view which party was responsible in law for paying him/her and for other employer related obligations.

*Regulation 8 therefore seeks to ensure that, where a recruitment company is supplying temporary workers, it only ever supplies those temporary workers as an **employment business**. In other words it must engage the work-seekers that it supplies to hirers for temporary assignments either under a contract of employment or a contract for services. It will also be responsible for their pay and any statutory benefits such as holiday pay. It will therefore be the workers' principal employer and the services of the worker will form part of its service to the hirer. VAT will be chargeable on the full amount of its charges to the hirer i.e. the salary element as well as its margin and employer's National Insurance contributions.*

Tax Representation

However, this regulation does not apply to:

agencies supplying workers for occupations in the entertainment or modeling sectors, which are listed in Schedule 3;

agencies and hirers connected with one another (as defined in regulation 3) e.g. in-house employment businesses.

7. 'Employment business' is defined for the purposes of the DTI's guidance as follows:

Employment Business

An employment business engages work-seekers under either contracts for services or contracts of employment and supplies those work-seekers to client hirers for temporary assignments or contracts where they will be under the hirers' supervision or control. This is usually known in the industry as the "supply of temporary workers". A company engaged in both "permanent recruitment" and "the supply of temporary workers" will fall into the definition of both employment agency and employment business to reflect both sides of the business.

8. 'Employment agency' on the other hand is defined in the DTI guidance as follows:

Employment Agency

Broadly speaking an employment agency introduces work-seekers to client employers for direct employment by those employers. This is usually known in the industry as "permanent recruitment" or employment even though the employment may only be for a fixed period.

9. Currently where the concession applies an employment business is able to supply a member of its staff to another business and VAT is not payable on the employee's remuneration, employer's National Insurance, and pension contributions etc. Usually VAT is payable only on the employment bureau's commission. The ending of this concession will mean that VAT will be payable on the full amount charged by the employment bureau including the employee's remuneration and related payments. This will not greatly affect fully taxable hirers (aside from a minor cash flow disadvantage). However, banks, insurance companies and other partly exempt businesses will be unable to recover all the VAT charged by the employment bureau. VAT will be a very large addition to the costs of employing temporary staff for these businesses.
10. Although the new provisions will prevent an employment bureau providing temporary staff as agent for the hirer/client it will not prevent the 'permanent

Tax Representation

recruitment' of staff for a fixed short period. In this situation the temporary worker becomes an employee of the employment bureau's client and only the recruitment fee is subject to VAT. Some partly exempt businesses may use this route to avoid VAT but it lacks the flexibility of the arrangements used hitherto for temporary workers. If businesses are encouraged to change their arrangements to avoid an additional tax burden they will operate less efficiently and the labour market will become distorted to some extent. Also many employees would lose the flexibility of temporary employment.

11. Bearing in mind that the employee is under the control and supervision of the client/hirer the imposition of VAT on the hire of temporary workers by an employment business amounts to a VAT charge on wages. This appears to be at odds with the theme of the tax.
12. We recommend that HMRC should seek legal advice on what is the consideration for the provision of staff by an employment business acting as principal. The working assumption in recent years has been that it is the total charge made by the employment business to the hirer/client. That may well be the correct position. However, case law on the correct amount of the consideration is not absolutely clear. There are two ECJ decisions which look to the amount that the supplier is able to keep for his own use as the amount of the consideration where he is providing a margin service. These cases are Glawe Spiel (Case C-38/93) and First National Bank of Chicago (Case C-172/96). Employment businesses almost always operate on a margin based on a percentage of the employee's salary and it is that amount that they are able to keep as their remuneration for the service they provide. We appreciate that there are other cases pointing in a different direction – see for example the Nell Gwynn House Maintenance Fund Trustees (House of Lords 1998 - [1999] STC 79). However, it is not beyond the bounds of possibility that the courts could decide that the consideration for the supply of staff is the amount of the commission only.
13. The argument that the supplier's margin or commission is the correct amount of the consideration does not run where the employee is under the direction and control of the supplier. In that situation there is a supply of specific services rather than the supply of staff. An example of this is contract cleaning where a supplier provides cleaning services in return for a specific charge. That is a different situation from the provision by an employment business of temporary staff to work under the control and supervision of the hirer/client whilst acting as cleaners. In that case the supply is the provision of staff not the supply of cleaning services. In reality and in practical terms the temporary worker is an employee of the hirer/client. In that situation it is arguable that VAT should not apply to the salary and other employment costs.
14. If there is a respectable argument for saying that the commission is the correct amount of the consideration when an employment business provides temporary workers we think that the concession should be continued. To do so will avoid the adverse economic consequences of the introduction of a new tax on employment to which we have referred above.

Tax Representation

KM.
11.09.06

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. Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members and students, 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 11,000 members of the ICAEW who pay an additional subscription.

Tax Representation

ANNEX B

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/taxfac/index.cfm?AUB=TB2I_43160,MNXI_43160.