



HOUSE OF LORDS

Select Committee on Personal Service
Companies

Report of Session 2013–14

Personal Service Companies

Ordered to be printed 31 March 2014 and published 7 April 2014

Published by the Authority of the House of Lords

London: The Stationery Office Limited
£13.50

HL Paper 160

The Select Committee on Personal Service Companies

The Select Committee on Personal Service Companies was appointed by the House of Lords on 12 November 2013 with the orders of reference “to consider the consequences of the use of personal service companies for tax collection.”

Membership of the Committee

Baroness Bakewell of Hardington Mandeville
Baroness Donaghy
Lord Empey
Lord Higgins
Lord Hope of Craighead
Lord Levene of Portsoken
Baroness Morgan of Huyton
Lord Myners
Baroness Noakes (Chairman)
Lord Palmer of Childs Hill
Lord Stewartby
Lord Woolmer of Leeds (resigned 12 January 2014)

Declaration of Interests

See Appendix 1.

A full list of Members’ interests can be found in the Register of Lords’ Interests:

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Committee Staff

The staff of the Committee were Patrick Milner (Clerk), Matthew Smith (Policy Analyst) and Helena Ali (Committee Assistant).

Contact Details

All correspondence should be addressed to the Clerk of the Select Committee on Personal Service Companies, Committee Office, House of Lords, London SW1A 0PW.

The telephone number for general enquiries is 020 7219 6612.

The email address for general enquiries is holsupport@parliament.uk

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Evidence is published online at
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References in footnotes to the Report are as follows:

Q refers to a question in oral evidence.

Witness names without a question reference refer to written evidence.

SUMMARY

The use of personal service companies has expanded significantly - a trend which mirrors the wider growth of the flexible workforce. The motivation to incorporate is not driven solely by financial incentives, although personal service companies may offer a number of such benefits, including the opportunity to make tax and National Insurance savings.

Concern surrounding the implications of the use of personal service companies for the collection of tax and National Insurance has persisted for a number of years. Legislation, often termed IR35, was much criticised in the evidence that we heard. The provisions are complex, and rely on contract-by-contract assessment and a sound understanding of case law to prevent abuse. This has driven the growth of a significant industry of professional advisers and accountants.

Some witnesses called for the suspension or abolition of IR35. Her Majesty's Revenue and Customs (HMRC) told us that such a measure would put £550 million of revenue at risk. This figure is an estimate and was not, in our view, directly substantiated by any publicly available information. Given that the justification for maintaining the IR35 provisions relies almost entirely upon this calculation of a deterrent effect, we believe that HMRC should publish a detailed assessment to justify maintaining the IR35 legislation.

If IR35 is to be maintained, the guidance which is currently made available to those affected must be improved. We recommend that HMRC undertake a full consultation on how the Business Entity Tests could work better to provide greater certainty to taxpayers. HMRC's Contract Review Service needs to be improved; in addition they should provide greater clarity as to the questions asked concerning service company usage on annual tax returns. In addition, the membership of the IR35 Forum should be reviewed.

We found that a significant number of lower paid individuals were engaged through corporate forms, including personal service companies. We heard concerns about the extent to which people were unaware of the potential negative implications of working through a company, particularly the absence of employment rights and entitlements, inadequate pension provision and exposure to potential HMRC compliance investigations.

We recommend measures to build awareness of such matters amongst the groups affected. We also recommend that the Low Pay Commission conduct a wider review of the use of companies by lower-paid workers, and the implications for pay, employment rights and statutory entitlements.

Finally, we found that the Government's guidance on off-payroll engagements in the public sector was being implemented inconsistently across departments, and that the full extent of these engagements within Government was not yet known. We recommend further measures to build confidence in public sector management of off-payroll engagements.

Personal Service Companies

CHAPTER 1: INTRODUCTION

Personal Service Companies: a growing phenomenon

1. Patterns of working within the UK labour market have been changing for some time. Freelancing has emerged as a preferred method of working for many and as our report demonstrates, successive Governments' attempts to introduce and administer appropriate methods of tax collection have been complex. Legislation first introduced in 2000, which came to be known as IR35, has been amended and bolstered by supplementary measures over the years in an attempt to respond to changing employment structures.
2. The term 'personal service company' is not defined in law. It is understood generally to mean a limited company, the sole or main shareholder of which is also its director, who, instead of working directly for clients, or taking up employment with other businesses, operates through his company. The company contracts with clients, either directly or through an agency, to supply the services of its director. This is the general understanding with which we approached our work.
3. The work of HMRC comes under particular examination in our report, as does the viability of a legal construction which assumes that a clear distinction between employment and self-employment can be made. We heard a great deal about the benefits for British businesses and the wider economy, though we also heard about the potential problems that can arise when the lower paid are engaged through structures which avoid a direct employment relationship. Following on from a previous Parliamentary inquiry,¹ we also received evidence discussing the use of personal service companies in parts of the public sector.

The Committee's work

4. In November 2013 the House appointed this *ad hoc* Committee to consider the consequences of the use of personal service companies for tax collection, and to make recommendations. The Committee's timetable was unusually short and its remit was accordingly closely defined. The Committee's membership is listed in Appendix 1.
5. From the outset it was clear that there were a number of discrete areas that had to be examined if we were to grasp the complexity of the issues. Our Call for Evidence was published on 20 November 2013 and attempted to cover this range of issues. It can be found in Appendix 3. By January, when we ceased to hear oral evidence, we had heard from 28 witnesses and received 44 pieces of written evidence.
6. The report is not intended to be a comprehensive reference work; instead it focuses on five main areas:

¹ Committee of Public Accounts, *Off-payroll arrangements in the public sector* (12th Report, Session 2012–13, HC 532).

- The use of Personal Service Companies, Relevant Legislation and Recent Trends (Chapter Two)
 - The Continuing Viability of the IR35 Legislation (Chapter Three)
 - HMRC's Administration and the Effect of Recent Reforms (Chapter Four)
 - Implications for the Lower-Paid (Chapter Five)
 - The Public Sector (Chapter Six)
7. As the inquiry progressed, it became clear that there was a general lack of understanding of how widespread the use of personal service companies was in the UK economy and of the complexity of the associated legislation. Previous examinations have been carried out by the Office of Tax Simplification (OTS) though as the bulk of the rules were only introduced in the year 2000, there have been few comprehensive studies to date.
 8. We were interested to discover that an entire industry has emerged as a result of the IR35 legislation and that a simple internet search returns numerous companies, publications and member bodies which exist to advise individuals of their tax position, campaign for reform and report relevant developments in the area as a whole.
 9. Whilst many witnesses were very willing to contribute to our inquiry, we were disappointed at the number of organisations and sectors which were reluctant to engage. This was particularly true of representatives of the IT and banking industries, which are commonly understood to be significant users of personal service companies, though there were notable exceptions. Consequently, it was difficult to ascertain how widely personal service companies were being used across all sectors and industries.
 10. We were surprised by the lack of co-operation from the Government. The Exchequer Secretary to the Treasury, who has responsibility for tax matters within Her Majesty's Treasury (HMT), refused to attend an oral evidence session citing that our enquiry was concerned with HMRC's application of the legislation. He also refused to allow Treasury officials to appear on the same grounds. The legal framework within which HMRC operates clearly affects the tax collection process and much of the evidence we received was concerned with the problems created by the IR35 legislation itself, not simply issues associated with its implementation. It was unfortunate that we were not able to discuss these issues with a Minister before making recommendations.
 11. We are grateful to the Committee's Specialist Adviser, Anita Monteith, for her assistance and advice.

CHAPTER 2: THE USE OF PERSONAL SERVICE COMPANIES, RELEVANT LEGISLATION AND RECENT TRENDS

Introduction

12. The use of personal service companies extends across a number of sectors of the economy and has expanded significantly in recent decades. This Chapter considers the reasons behind this trend, and provides an initial outline of relevant legislation which has affected the use of personal service companies. It concludes with a brief summary of recent initiatives undertaken.

The use of Personal Service Companies

13. In certain sectors of the economy—information technology and the oil and gas sector in particular—it is a long standing practice for individuals to set themselves up as personal service companies, providing their services as consultants to clients, rather than working directly as employees.
14. Use of personal service companies extends into other sectors, where these arrangements may be less prevalent but are still not uncommon. It is certainly the case that many interim managers, in both the public and private sectors, choose to work through personal service companies; the Institute of Interim Management (IIM) estimated that there were up to 16,000 interim managers in the UK providing their services on a freelance basis. They told us that around 88% of these interim managers operate through their own limited companies.²
15. Personal service companies have also been used by senior executives. In February 1993 it came to public attention that the then Director General of the British Broadcasting Corporation (BBC) was engaged through a limited company and was not, therefore, a BBC employee.³ Public sector use of personal service companies to engage senior officials came to the fore once more in 2012, with the news that the Chief Executive of the Student Loans Company was engaged through a personal service company. The Government subsequently undertook a review of public sector use of personal service companies and made a number of changes, implemented through Procurement Policy Note 07/12.⁴
16. The trade association Oil and Gas UK told us that, in their area of work, it was particularly common for individuals to deliver their work through personal service companies, and that personal service companies had been a feature of the labour market in the oil and gas industry for many years. They suggested that in certain areas of operation, including engineering design, construction and project management, more than 80% of personnel were engaged off-payroll.⁵

² IIM, written evidence. Interim managers are used to fill short-term management vacancies in both the public and private sectors.

³ On 1 March 1993 the BBC announced that this arrangement had been changed and that the Director General would henceforth be engaged as an employee.

⁴ See Chapter six.

⁵ This figure will include those engaged through other off-payroll arrangements, such as agency PAYE, as well as those engaged through personal service companies.

17. Other sectors where the use of personal service companies is common were identified during the course of our work; these included construction, engineering, teaching and entertainment. We sought an indication of recent trends in the use of personal service companies; robust figures on the overall numbers of these companies are not available, although a number of estimates were made.
18. HMRC estimated that the current personal service company population was around 200,000. HMRC's estimate for 1999, when the IR35 rules were first suggested, was 90,000. HMRC explained that they "do not routinely estimate the size of the personal service company population, because that information of itself is not terribly useful for our operational compliance activity. It is a pretty broad-brush estimate of a certain type of company".⁶
19. Witnesses expressed some support for these figures. The Freelancer and Contractor Services Association (FCSA), a body representing companies who provide accountancy and other services to freelancers, suggested that these figures were "broadly accurate".⁷ The Institute of Chartered Accountants in England and Wales (ICAEW) told us that the figure of 200,000 companies "would not seem at all unrealistic to us".⁸
20. The Professional Contractors Group (PCG), a trade association representing freelancers, was concerned that HMRC estimates were based upon a number of assumptions, which were not publicly known. The IIM felt that estimates did not appear to be underpinned by any statistical analysis. HMRC told us that only 1,000 individuals had answered the service companies question on their 2011–12 Self Assessment Tax Return (form SA100).⁹ This is some way from the 200,000 estimate for the overall personal service company population, although HMRC offered a number of potential reasons for non-completion.¹⁰
21. Despite the lack of clarity surrounding the overall total of personal service companies, the large majority of our witnesses felt that numbers had increased over the past decade. John Whiting, Tax Director at the OTS, told us that "The numbers have certainly gone up, however you look at it, over the period that IR35 has been around".¹¹ Patrick Stevens, Tax Policy Director at the Chartered Institute of Taxation, told us that "Certainly my perception is that it has been steadily growing during the course of the last five or six years".¹²

The growth of personal service companies: 'push' and 'pull' factors

22. We were told of a number of potential tax advantages for individuals using a personal service company. Firstly, the range of expenses which the personal service company can set against its taxable profits will be wider than that

⁶ Q1

⁷ FCSA

⁸ Q 34

⁹ The question asks: "If you provided your services through a service company (a company which provides your personal services to third parties), enter the total of the dividends (including the tax credit) and salary (before tax was taken off) you withdrew from the company in the tax year".

¹⁰ Q 118

¹¹ Q 13

¹² Q 34

which an employee can set against his or her taxable income.¹³ Secondly, there may be a cash-flow benefit in avoiding tax being deducted at source under PAYE each month. Thirdly, it may be possible for individuals to retain within the business any earnings which are not immediately required as income, reducing tax liability through the application of corporation tax or capital gains tax.

23. In addition, the individual may be in a position to receive dividends out of the company, instead of receiving a salary, and this could eliminate his or her National Insurance liability. It is possible to qualify for benefits whilst paying no National Insurance contributions. Individual contractors who pay themselves a salary from their personal service companies between the lower earnings limit and the ‘primary threshold’ (£109 and £149 per week respectively in 2013–14) will not pay employee National Insurance contributions but will still be treated as a contributor.¹⁴ Similarly, there are no employer contributions on earnings below the secondary threshold, which is currently £148 per week (2013–14). It is, therefore, possible to draw a salary of £148 or less per week to ensure benefit cover without making either employer or employee NI contributions.¹⁵
24. Other, non-tax, reasons may lead an individual to choose to operate through a personal service company; the PCG told us that 84% of their members choose to incorporate for non-tax reasons.¹⁶ These reasons include limited liability and flexibility; we were also told that operating through a company provides ‘credibility’ in some industries.¹⁷ John Whiting told us that:

“Operating on one’s own is increasingly a lifestyle choice for many people, and once that decision has been taken, operating through a personal service company can make sense for many reasons ... Saving (tax) money will always be a factor, though not necessarily the main driver”.¹⁸

25. In some industries, where skills are at a premium, individuals can choose to operate through a personal service company. Oil and Gas UK told us that the number of personal service companies engaged had increased, because highly skilled individuals could insist upon their use:

“The principal reason why it is so high in our particular industry is supply and demand. We compete globally for talent. Many of our members operate globally and deploy their resources on that basis. The industry in the UK has been very technically challenging and is quite mature, so the expertise that has been developed is highly prized and valued throughout the world. It has been a feature for some time, but I think the proportion has increased ... We have vacancies for literally

¹³ Income Tax (Trading and Other Income) Act 2005, section 34. Expenses incurred wholly and exclusively for the purposes of the trade are deductible in arriving at taxable profits of an unincorporated business. Income Tax (Earnings and Pensions) Act 2003, section 336(1)(b). Expenses incurred wholly, exclusively and necessarily in the performance of the duties of the employment may be deducted from an employee’s taxable earnings., Corporation Tax Act 2009, section 54. Expenses incurred wholly and exclusively for the purposes of the trade are deductible in arriving at taxable profits of a personal service company.

¹⁴ PCG, supplementary written evidence.

¹⁵ BCS, the Chartered Institute for IT

¹⁶ Q 44

¹⁷ *Ibid.*

¹⁸ John Whiting

thousands of people in the industry ... the driver has come very much from the individuals themselves, and there is certainly a desire to reduce that ratio among our members”.¹⁹

26. There are, however, some potential disadvantages for individuals choosing to operate through a personal service company. These can include lack of holiday pay, sick pay and paid training, and the absence of various rights and protections such as maternity leave and working time protections. Pension entitlements may suffer, with it being unlikely that individuals would benefit from workplace pension provision.
27. In addition, the impetus for operating through a company can come from the engager, rather than the individual. The engager is under no obligation to pay employers’ National Insurance contributions, and also does not have to provide the various rights and entitlements, as set out above, that would be offered to a regular employee.
28. The FCSA told us that: “In a number of sectors/industries either recruitment businesses and/or end clients insist on the use of a limited liability supplier for flexible workers. This is driven by managing the risk of employment rights and unpaid taxes”.²⁰ Amey plc told us that, “for tax risk reasons”, it rarely takes on a freelance consultant for a temporary contract unless he or she agreed to operate through a personal service company.²¹ The ICAEW cited the broadening scope of employment law and new entitlements for employees as driving the growth of personal service companies. They told us that there would “be pressure from employers in a wider sense for people to adopt these structures in certain cases” and that this would continue, “absent any major policy changes”.²²
29. More generally, we heard that the growth in the number of personal service companies was a reflection of structural changes in the UK labour market. The Institute of Directors (IoD) suggested that:

“Since the 1990s and particularly so in the aftermath of the credit quake, many businesses have needed to adopt more flexible business models as the predictability and security of their revenues has been adversely influenced by macroeconomic factors. Most businesses consider themselves to have a less powerful position in relation to their customers but a more powerful position in relation to their suppliers and employees. Accordingly, we consider it is wholly unsurprising that there has been a growth in the use of personal service companies where their use is sustainable”.²³
30. A changing regulatory environment may also have been partly responsible for increasing numbers. The Conduct of Employment Agencies and Employment Business Regulations 2003, commonly known as the ‘conduct Regulations’ or ‘agency Regulations’, came into force in April 2004.²⁴ The Regulations govern the conduct of the private recruitment industry and

¹⁹ Q 75

²⁰ FCSA

²¹ Amey plc

²² Q 39

²³ IoD

²⁴ See <http://www.legislation.gov.uk/ukxi/2003/3319/made> SI 2003 No 3319, made under the Employment Agencies Act 1973.

establish a set of minimum standards that clients (both engagers and work-seekers) are entitled to expect.²⁵ Under the regulations, an employment business must ensure that temporary workers are paid for all the work that they do (even if payment has not been received from the end-client), that they receive paid holidays and that they are not forced to work longer than 48 hours per week. A range of further provisions and protections apply.

31. Regulation 32 offers a personal service company the opportunity to opt out of the Regulations.²⁶ The decision to opt out must be notified in advance of the contract commencing, and lasts only for the duration of the contract in question.
32. A large proportion of contractors source their work through agencies, rather than directly from end-clients. We were told that some engagers and employment agencies encouraged individuals to provide their services through a personal service company, in order to avoid liabilities under these regulations and thereby reduce costs.²⁷ The IIM told us that they advise their members to opt out when negotiating contracts;²⁸ APSCo, a trade body representing recruitment companies, told us that 98.6% of contractors who secure work through their members opted out of these provisions.²⁹
33. Sections 44 to 47 of the Income Tax (Earnings and Pensions Act) 2003 were also said to have played a role in the growth in numbers of personal service companies. These provisions require employment agencies to make deductions for PAYE from the earnings of the worker that they engage and supply to clients, where that worker is subject to the client's supervision, direction or control. The PCG stated that:

“Recruitment agencies will typically insist upon freelancers using a limited company. Agencies would be exposed to large legal and tax liabilities if they were to pay a sole trader gross because of sections 44–47 of the Income Tax (Earnings and Pensions) Act, therefore they prefer to deal with an individual working via their own limited company”³⁰

Kate Cottrell, an IR35 specialist who runs her own advice firm, agreed that these provisions had had a significant effect upon the growth in personal service company numbers.³¹

34. The Agency Worker Regulations,³² which came into force in October 2011, also appear to have had an effect. The Regulations give agency workers the entitlement to the same basic employment and working conditions as if they had been recruited directly, once they have completed a qualifying period of 12 weeks in the same job.³³

²⁵ Department for Trade and Industry, *Guidance on the Conduct of Employment Agencies and Employment Business Regulations*, 2003.

²⁶ See <http://www.legislation.gov.uk/ukxi/2003/3319/regulation/32/made> SI 2003 No 3319, made under the Employment Agencies Act 1973.

²⁷ Giant Group

²⁸ IIM

²⁹ Q 48

³⁰ PCG

³¹ Q 23

³² See http://www.legislation.gov.uk/ukxi/2010/93/pdfs/ukxi_20100093_en.pdf , SI 2010 No. 93, made under the Health and Safety at Work Act 1974 and the European Communities Act 1972.

³³ Department for Business, Innovation and Skills, *Agency Workers Regulations: Guidance*, May 2011.

35. The definition of agency worker to which the Regulations apply excludes cases where there is a contract whereby the agency or the end hirer is dealing with an individual carrying out a profession or business undertaking.³⁴ Guidance to the regulations makes clear that “individuals who find work through a temporary work agency but are in business on their own account (where they have a business to business relationship with the hirer who is a client or customer)” are likely to fall outside the scope of the Regulations.³⁵
36. We were told that this exemption for personal service companies had encouraged movement of individuals from other intermediaries, such as umbrella companies, into personal service companies. APSCo told us that:
- “The agency workers regulations increased the number of contractors moving from umbrella models to personal service company models, certainly in the professional sector. The main reason for that, we understand, was that professional contractors do not want the protections afforded to them by this employment-related legislation”.³⁶
37. Others, however, felt that the ‘push’ came from the agencies. A major umbrella company, the Giant Group, told us that the use of umbrella companies was declining as more and more individuals were “pushed” into using personal service companies by agencies, in order to avoid the Agency Worker Regulations and the 2003 Regulations.³⁷ The use of umbrella companies is considered in more detail in Chapter five of this report.
38. It is apparent that a number of factors, including labour market changes, regulatory changes and, in some industries, skills shortages, have driven the growth in the number of personal service companies over recent years. This growth has taken place despite the introduction, in 2000, of the ‘IR35’ rules.

The IR35 legislation

39. This section provides some brief background to the IR35 rules. A more detailed consideration of the operation and efficacy of the rules is provided in Chapter three.
40. As part of the March 1999 Budget, it was proposed that a number of changes would be made to ensure that people working through personal service companies in a manner that could be considered ‘disguised employment’ would, in practice, pay the same tax and National Insurance as someone employed directly. Details were provided in a press notice issued at the time of the Budget, which was numbered ‘IR35’.³⁸ The legislation which has developed subsequently is commonly known as the ‘IR35 legislation’, or ‘IR35 rules’.
41. The IR35 press notice stated that:
- “Businesses employing their workers directly say that they are unable to compete with those encouraging the avoidance at which the new legislation is aimed. As a result, ordinary workers can find they are

³⁴ SI 2010 No. 93, paragraph three.

³⁵ Department for Business, Innovation and Skills, *Agency Workers Regulations: Guidance*, May 2011.

³⁶ Q 48

³⁷ Giant Group

³⁸ Inland Revenue Budget press notice IR35, *Countering avoidance in the provision of personal services*, 9 March 1999 (Appendix 5).

unable to compete for jobs with those willing to participate in such arrangements. But those who do participate often have to pay a price in terms of loss of protection under employment law ... The proposed changes are aimed only at engagements with essential characteristics of employment. They should affect only those cases where these characteristics are disguised through the use of an intermediary—such as a service company or partnership. There is no intention to redefine the existing boundary between employment and self-employment”.³⁹

42. Legislation was introduced in the Finance Act 2000.⁴⁰ The income tax provisions related to IR35 were contained in section 60 and Schedule 12 of the Act. Measures relating to National Insurance were introduced in the Social Security Contributions (Intermediaries) Regulations 2000.⁴¹
43. The explanatory notes for the Finance Bill explained that Schedule 12 introduces “new rules concerning the taxation of workers who provide their services to clients through intermediaries, such as personal service companies”.⁴² They went on to state that: “The new rules use existing case law to define an employee and determine that, where workers meet that definition in relation to work done for their clients, they will pay broadly the same tax and NICs as an employee, even if they provide their services through an intermediary”.⁴³
44. Section 60 of the Act gives effect to Schedule 12. Schedule 12, paragraph 1 states that:

“This Schedule applies where—

 - (a) An individual (“the worker”) personally performs, or is under an obligation personally to perform, service for the purposes of a business carried on by another person (“the client”),
 - (b) The services are provided not under a contract directly between the client and the worker but under arrangements involving a third party (“the intermediary”), and
 - (c) The circumstances are such that, if the services were provided under a contract directly between the client and the worker, the worker would be regarded for income tax purposes as an employee of the client”.⁴⁴
45. Schedule 12, paragraph 2 states that:

“If, in the case of an engagement to which this Schedule applies, in any tax year—

³⁹ *Ibid.*

⁴⁰ Finance Act 2000, available at: <http://www.legislation.gov.uk/ukpga/2000/17/contents>

⁴¹ SI 2000 No 727. Corresponding regulations for Northern Ireland were made in SI 2000 No 728. These regulations were made under the Welfare Reform and Pensions Act 1999 (sections 75 and 76); an amendment was introduced during the passage of the Bill to facilitate the making of these regulations.

⁴² Explanatory note for Finance Bill 2000, clause 59 and Schedule 12, available at: <http://www.hmrc.gov.uk/ir35/explanatorynote.pdf>

⁴³ *Ibid.*

⁴⁴ Finance Act 2000, Schedule 12.

- (a) The conditions specified in paragraphs 3, 4 and 5⁴⁵ are met in relation to the intermediary, and
- (b) The worker, or an associate of the worker—
 - (i) Receives from the intermediary, directly or indirectly, a payment or other benefit that is not chargeable to tax under Schedule E, or
 - (ii) Has rights entitling him, or which in any circumstances would entitle him, to receive from the intermediary, directly or indirectly, any such payment or other benefit.

The intermediary is treated as making to the worker in that year, and the worker is treated as receiving in that year, a payment chargeable to income tax under Schedule E”.⁴⁶

46. Parts 2 and 3 of Schedule 12 set out detailed computational rules, including those used for calculating any tax payments to be made. These complex rules provide for notional calculations to be made, based on deemed payments and set deductions.
47. The provisions contained within Schedule 12 provide the essence of the IR35 rules, with “the circumstances” referred to in paragraph 1 (c) being determined on the basis of case law regarding employment for income tax purposes. The use of case law in this manner has been central to subsequent discussion about the complexity of the rules.⁴⁷
48. Schedule 12 applies to specific contracts, rather than the wider, fuller activity of a worker or intermediary. As such, the IR35 rules apply on a ‘contract-by-contract’ basis. This aspect of the rules adds further complexity; John Whiting described the approach as “innately clumsy”.⁴⁸
49. The introduction of these rules was controversial at the time. The PCG stated that the proposals “show astonishing naiveté of the knowledge-based entrepreneurial sector and tip the balance in favour of large US companies at the cost of small British enterprises”. The Chairman of the PCG described the measures as “a body blow to enterprise culture”.⁴⁹
50. In October 2000 the PCG was granted leave by the High Court to proceed with a judicial review to examine whether the legislation was consistent with the Human Rights Act 1998. On 2 April 2001 the Court decided in favour of the Revenue on all counts, awarded costs to the Revenue and refused the PCG leave to appeal.⁵⁰

⁴⁵ Paragraph three sets out criteria which identify company intermediaries to which the rules apply. Paragraph four introduces the criteria which identify partnership intermediaries to which the rules apply, and paragraph five identifies intermediaries who are individuals to which the rules would apply.

⁴⁶ Finance Act 2000, Schedule 12.

⁴⁷ See Chapter three.

⁴⁸ Q 15

⁴⁹ PCG Press Notice No 12/99, 23 September 1999.

⁵⁰ *R (on the application of Professional Contractors Group Ltd) v Inland Revenue Commissioners* [2001] EWHC (Admin) 236.

Subsequent changes to the legislation

51. The rules first set out in the 2000 legislation were consolidated in the Income Tax (Earnings and Pensions) Act 2003, with the relevant provisions being found in Chapter eight. The original paragraphs set out in detail above are replicated in sections 49 and 50 of the 2003 Act.⁵¹
52. In the Finance Act 2007 the Government introduced legislation relating to managed service companies.⁵² Managed service companies offered a vehicle through which contractors could place their accounting and invoicing processes, without having to manage directly these functions themselves. Prior to the managed service companies legislation, it was not uncommon for groups of up to 20 contractors to form a composite company, in which they were all shareholders. This limited the running costs of the business, and allowed the individuals concerned to take remuneration in the form of dividends rather than salary, offering tax benefits. It was thought that this structure was being used to circumvent the IR35 provisions.
53. A more recent change was introduced following the Government's review of off-payroll arrangements in the public sector. The review, and its recommendations, are considered in more detail in Chapter six of this report.
54. Following the review, the Chief Secretary to the Treasury announced a consultation about 'controlling persons'. Even if these individuals provided their services through personal service companies, the engaging organisations would be responsible for deducting income tax and National Insurance as if they were employees on the payroll.⁵³ In the event, this initiative was not pursued. Instead, the Finance Act 2013 introduced an amendment to section 49(1)(c) of the income tax (Earnings & Pensions) Act 2003 which specified that the IR35 rules can apply to 'office holders', as well as those who might be engaged in circumstances which could be considered to constitute employment.⁵⁴

Recent debate and proposals for reform

The OTS Review of Small Business Taxation

55. In July 2010 the Government announced that a review of small business taxation would be undertaken by the OTS, and that this would include exploring alternative legislative approaches to IR35.⁵⁵ The OTS was asked to:
 - Identify and provide evidence of the complexity and uncertainty created by IR35;
 - Consider alternative legislative approaches that would be simpler and create certainty while ensuring that, where intermediaries are used to disguise employment, any income that is effectively employment income is taxed fairly; and

⁵¹ The one substantive change is to remove the reference to Schedule E, with reference instead made to 'employment income' and 'earnings from employment'.

⁵² Part 3, section 25. Detailed provisions contained in Schedule 3.

⁵³ HC Deb, 23 May 2012 col 1161.

⁵⁴ Provision to this effect is made in Finance Act 2013, section 22.

⁵⁵ HMT press notice 29.10, 20 July 2010.

- Consider the scope for tax avoidance and the extent to which alternatives to IR35 would affect it.⁵⁶
56. The OTS published an interim report in March 2011. The main recommendation was that the Government should look at the integration of income tax and national insurance. This would remove one of the incentives for incorporation. Recognising that this would take some time to achieve, the OTS identified three options which could deliver more immediate improvements to the impact of IR35.⁵⁷ The first option was to suspend IR35, with a view to permanent abolition. The OTS stated that:
- “From the perspective of simplification, abolition of IR35 delivers the greatest improvement, providing individuals with certainty over tax status and removing legislation ... The OTS’s view is that a commitment from the Government to the integration of income tax and NICs would lead to a reduction in the tax motivation for incorporation, and would limit the long term cost of this option ... The OTS is not in a position to calculate the amounts at risk but it could clearly be significant; work on the figures is needed and must be realistic”.⁵⁸
57. The second option put forward was for HMRC to improve the administration of IR35. It was suggested that improvements could deal with issues such as the fear of investigation, the length of time an investigation takes, and enabling individuals to self certify their IR35 status. More consistency from HMRC was also thought to be required.⁵⁹
58. Finally, it was suggested that the Government might wish to consider the introduction of a test which would exempt some businesses from IR35 entirely. The proposal was to establish a range of simple tests that those at risk of falling within IR35 could apply to their situation, in order to gain a measure of certainty regarding their status.
59. In the Budget Report 2011 the Government stated that IR35 would be retained “as abolition would put substantial revenue at risk”.⁶⁰ The Government were, however, committed to making clear improvements in the way that IR35 is administered. A number of changes to HMRC’s enforcement and compliance activities on IR35 have been made since then; the effect of these is considered in Chapter four of this report.

Autumn Statement 2013 and Finance Bill 2014

60. In the Autumn Statement 2013 the Government set out a number of measures which seek to make a clearer distinction between employment and self-employment. These measures are of contextual relevance to the work of the Committee, illustrating that the difficulties encountered in determining employment status extend across a wide range of engagements and situations.

⁵⁶ HM Treasury, *Small Business Tax Review: terms of reference*, (2012). Available at: <https://www.gov.uk/government/publications/small-business-tax-review/small-business-tax-review-terms-of-reference>

⁵⁷ The findings of the OTS review, and the Government response to it, are considered in more detail in Chapter three.

⁵⁸ OTS, *Small Business Tax Review*, March 2011, pp. 39–42.

⁵⁹ *Ibid.*

⁶⁰ HC 836, March 2011, paragraph 2.203.

61. One such measure deals with onshore employment intermediaries, with draft legislation set out in an HMRC consultation document published in December 2013.⁶¹ The measures proposed seek to target PAYE and National Insurance avoidance; the intermediaries in this context are usually employment agencies, working through a complex structure of companies to avoid tax and National Insurance, as well as the payment of holiday pay. The proposed new rules will focus on whether the individual is subject to, or has the right of, supervision, direction or control as to the manner in which their duties are carried out. If an intermediary or agency contracting with the end client exercises control it will have to operate PAYE and also pay National Insurance contributions.
62. The Autumn Statement also contained proposals dealing with salaried partners in Limited Liability Partnerships (LLP).⁶² At present, it is possible for a salaried partner of an LLP to receive more favourable tax treatment than an individual who is an employee of a company engaged on similar terms.⁶³ The LLP is also not liable for employer's National Insurance contributions on a member's profit share. The Government propose treating an LLP member as an employee for tax and National Insurance purposes if each of three new tests are met.⁶⁴ These new rules are expected to come into force on 6 April 2014.
63. The third of the relevant Autumn Statement proposals deals with offshore employers who have no presence, residence or place of business in the UK. These structures, often involving chains of intermediaries, are increasingly being marketed and promoted as a legitimate way to avoid employer's National Insurance. Benefits for the individual are sometimes further enhanced through the use of Employee Benefit Trusts and other mechanisms to limit further the tax payable on any income.
64. Following consultation in May 2013,⁶⁵ the Government confirmed, in the Autumn Statement 2013, that they would create obligations on offshore employers employing workers in the UK. If the offshore employer fails to pay the charge can be moved to an onshore engager of the labour. It is likely that the liability will attach to the intermediary which is closest in the chain to the business which uses the worker.⁶⁶ These changes will also take effect from 6 April 2014.

⁶¹ HMRC, *Onshore Employment Intermediaries: False Self-Employment, Consultation document*, (2013). Available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/264649/Onshore_employment_intermediaries_-_false_self_employment.pdf.

⁶² HMRC, *Partnerships review: limited liability partnerships: treatment of salaried members*. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/264620/4_Partnerships.pdf

⁶³ The Limited Liability Partnerships Act 2000 introduced a provision allowing members of an LLP to be taxed as if they were partners in a partnership established under the Partnership Act 1890 (i.e. a traditional partnership), even if they were engaged on 'salaried partner' terms.

⁶⁴ The proposed tests are as follows: (i) The member performs services for the LLP in his or her capacity as a member, and is expected to be wholly or substantially rewarded through a 'disguised salary' that is fixed or, if varied, varied without reference to the profits or losses of the LLP; (ii) The member does not have 'significant influence' over the affairs of the partnership; (iii) The member's investment contribution to the LLP is less than 25% of the 'disguised salary'.

⁶⁵ HMRC, *Offshore Employment Intermediaries Summary of Consultation Responses*, (2013). Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/249786/Summary_of_Responses_Offshore_Employment_Intermediaries.pdf

⁶⁶ PWC, United Kingdom: Tax changes announced in the Autumn Statement, 5 December 2013.

CHAPTER 3: THE CONTINUING VIABILITY OF THE IR35 LEGISLATION

Introduction and Background

65. The primary focus of the Committee's investigation was on the use of personal service companies and the associated consequences for tax collection. The inquiry raised broad questions about the associated legislative framework. Within these broader issues, the core questions which we address stem from the IR35 legislation, its interpretation and HMRC's ability to administer and monitor it.
66. The 1999 Budget Press notice 'IR35' which announced the introduction of the rules stated:
- “There has for some time been general concern about the hiring of individuals through their own service companies so that they can exploit the fiscal advantages offered by a corporate structure. It is possible for someone to leave work as an employee on a Friday, only to return the following Monday to do exactly the same job as an indirectly engaged ‘consultant’ paying substantially reduced tax and national insurance. The Government is going to bring forward legislation to tackle this sort of avoidance”.⁶⁷
67. We were conscious that any consideration of the success or otherwise of the legislation should take account of these original aims and so we sought to investigate whether the practice outlined above was still commonplace. Whilst we heard very little evidence of individuals leaving employment only to return in a ‘consultant’ role, we did hear from some in the private sector about the commercial benefits of recruiting individuals through limited companies.⁶⁸
68. We were also interested in what drove people to incorporate more generally in the first place and the extent to which this was motivated by a potential tax advantage. HMRC explained to us that in their opinion, the growing phenomenon of personal service companies could be explained “primarily for commercial reasons but, it also has to be said, partly to avoid or mitigate tax”.⁶⁹ In response to this, the IR35 legislation itself had been drafted to ensure that broadly the same tax is paid by applying a tax framework akin to that of a conventional employment relationship.
69. There appear to be particular problems in having to apply the rules on a contract-by-contract basis, which can make them especially cumbersome. As mentioned in the previous Chapter,⁷⁰ the IR35 legislation applies to engagements which, but for the presence of an intermediary (such as the personal service company), would be regarded as conventional employment relationship. This has the aim of ensuring that broadly the same amount of tax and National Insurance is paid regardless of the use of an intermediary. This judgment is applied on a contract-by-contract basis, rather than by

⁶⁷ Appendix 5

⁶⁸ Oil and Gas UK and Amey plc

⁶⁹ Q 5

⁷⁰ Paragraphs 44 and 45

reference to the totality of the activity of the individual who works through a personal service company. Consequently, contractors find that they have to consider whether IR35 applies to each of the contracts under which they operate rather than establish the tax status of their personal service company.

70. Our Call for Evidence⁷¹ asked the following question: “To what extent does the current IR35 legislation impose additional compliance burdens and administrative costs?” This question sought to gather information on both the compliance and administrative costs to Government, in the form of HMRC, and to British business. The PCG told us of the expensive administrative and cost implications of contractors having to seek accountancy advice and private contract reviews.⁷² We deal with HMRC’s administration costs in Chapter 4.
71. The IR35 legislation was initially justified on the basis of a significant risk to the Exchequer of the loss of tax and National Insurance revenue. HMRC initially told us that the Exchequer risk was £475m but when we asked them to provide further details we were told that the total estimated fiscal risk was now £550m. HMRC provided the Committee with a breakdown of this figure⁷³ which comprised an Exchequer yield of £30m and Exchequer protection of £520m, the latter figure having increased in recent years, partly because of a reduced estimated income threshold at which HMRC consider an individual may decide to establish and operate through a personal service company. We were told that the Exchequer protection figure was made up of:
- (1) £115m from people who currently provide their services through a personal service company and who would pay a greater proportion of their income through dividends in the absence of IR35. This is calculated as 220,000 directors estimated to be deterred from avoiding £500 per person on average; and
 - (2) £405m which is made up of people who are currently directly employed who would incorporate and provide their employment services through a personal service company were it not for IR35. This is calculated as 55,000 employees who would incorporate and avoid tax and National Insurance of around £8,000 per person on average.⁷⁴
72. The reliability of these figures formed part of our questioning to HMRC when they appeared before us for the second time at the end of our inquiry. We were told that HMRC aimed to derive a reasonable central estimate of the costs of any measure in the Knowledge, Analysis and Intelligence Directorate and that this was subject to a quality assurance process before it was scrutinised further by the Office for Budget Responsibility.⁷⁵ It was not clear to us that these figures were reliable. The 220,000 directors cited in connection with Exchequer protection was a higher population than the figure of 200,000 which we were given for the number of operating personal service companies and it was not clear on what basis either this population or the figure of £500 per director had been calculated. In respect of the 55,000

⁷¹ Appendix 3.

⁷² PCG.

⁷³ HMRC, Q2 and Q116

⁷⁴ HMRC and Q116

⁷⁵ Q 116

employees who would move to incorporate in the absence of IR35, we were told that this represented 4% of employees who earn over £50,000. We were also told that the OTS had estimated that 1.8% of individuals with an employment income of between £50,000 and £150,000 might incorporate in the absence of IR35.⁷⁶ HMRC made it clear repeatedly that these overall figures were only estimates based on the available evidence. Given the critical importance of these calculations in justifying the existence of the IR35 legislation, we were of the opinion that more robust work was needed in this area.

73. **We recommend that Her Majesty's Revenue and Customs carry out and publish a detailed assessment of the current Exchequer protection figure and of the costs that taxpayers incur in dealing with IR35. This should enable a better assessment of whether the legislation is having the intended effect and is proportionate.** (Recommendation 1)

The effectiveness of the legislation

74. The Committee heard from a wide range of interested parties who consider that the current legislation is ineffective; a large number of the written submissions made this point forcefully. Contractor Calculator, an independent, online guide for contractors, stated that: "It does seem somewhat wasteful having industry experts and HMRC standing around a dead horse discussing how they can make it win the race. It's a non-runner, and has been since inception".⁷⁷ The broad sentiment expressed here was echoed by many. The Association of Accounting Technicians (AAT) and Chartered Institute of Payroll Professionals (CIPP) argued that the legislation was poorly thought through when drafted and remained unclear. Their argument seemed to be a qualitative one based on the ambiguity of the rules and uncertainty amongst taxpayers who were expected to abide by them. HMRC acknowledged that they were aware that many find the legislation difficult to understand but maintained that, on the whole, understanding had increased over the years.⁷⁸
75. A great deal of evidence was submitted which displayed a high degree of hostility to the legislation in its current form. Many viewed the legislation as outdated, attempting to address a situation and market which in reality no longer existed. We were told that HMRC were trying to apply an outdated method of taxation to a new, emerging way of working.⁷⁹ The IIM suggested that the 'rules' did not reflect the underlying reality of the way freelancers worked and the Interim Management Association (IMA) argued that the legislation needed updating to be more reflective of the maturing labour market. The reliance on case law as a method of assessment, and a preoccupation with defining the tax position on a contract-by-contract basis appeared to be the primary criticisms here and an alternative approach is discussed in the next Chapter.⁸⁰

⁷⁶ Q 116

⁷⁷ ContractorCalculator

⁷⁸ Q 8

⁷⁹ Peter Disney

⁸⁰ Paragraph 131.

76. Conversely, organisations such as G4S plc, Amey plc and Oil and Gas UK, all responding as clients of personal service companies, were more supportive. Amey plc suggested that the principles of IR35 were appropriate and pragmatic, whilst G4S plc suggested that, as a client, they felt that the legislation was effective and efficient in managing the tax risks of using intermediaries. We were told very clearly by various parties from the business sector that the status quo should be maintained, though it was less clear whether this was an objective assessment of the situation or simply an appraisal of how the current rules are beneficial for their current business models. We were also mindful that Government and the public sector are significant users of personal service companies, arrangements which can benefit all parties in a similar way to those in the private sector. The Confederation of British Industry (CBI) and the IoD echoed this sentiment of approval in their oral evidence to the Committee,⁸¹ but again, their satisfaction was less rooted in the benefits for the Exchequer and more in the flexibility that current arrangements afforded to their members.
77. It is clear that in certain situations, the use of personal service companies can be beneficial for business. The oral evidence given by Amey plc summarised the potential benefits well:
- “We need access to specialist skills, commonly at short notice, for a limited duration. To have that level of resource on the books permanently is expensive and inefficient if we have people sitting around waiting for a particular project to happen ... if we need somebody for three months or six months and we give them an employment contract, that raises a whole host of issues that are disproportionate to the intended length of the relationship and can include equality of employee rights, auto-enrolment for pensions and involvement in our flexible benefits reward scheme. A lot of administrative structures are built around permanent employment that are simply not appropriate for somebody who is only going to be in the business for three or six months”.⁸²
78. **Serial contracting is a feature of the modern British workforce and is supported by both businesses and contractors. We heard that although IR35 is not a significant issue for businesses, it can arouse considerable hostility from contractors.**
79. **Moreover, we note that compliance with the rules can demand a great deal of time and effort on the part of contractors. We acknowledge that it can be difficult for individuals contracting through personal service companies to define their tax and National Insurance position quickly and accurately because of the contract-by-contract nature of IR35 and the need for a sound understanding of case law.**

The Call for Reform

80. We were aware that there were strong opinions on the complexity and appropriateness of the IR35 legislation. As noted in Chapter 2, the Government asked the OTS to look at alternative approaches as part of its Review of Small Business Taxation which reported in 2011. Our Call for

⁸¹ QQ 93–104

⁸² Q 76

Evidence asked the following question: “Should the current intermediaries legislation be reformed and if so, what would be the alternatives?”

81. The OTS’s suggestion of an eventual merging of income tax and National Insurance⁸³ was supported in evidence to us by Professor Judith Freedman (Pinsent Masons Professor of Taxation Law at the University of Oxford), AAT, CIPP and Contractor Calculator.⁸⁴ Similar points were made by the ICAEW and Julius Hutson, a Chartered Accountant. This was rejected by the Government in their response to the OTS’s report in 2011.⁸⁵
82. The OTS also presented some IR35 reform options in its 2011 report, the first of which was suspension of the legislation prior to permanent abolition. This was supported by the PCG⁸⁶ and others in evidence to us. On this point, Mr Whiting, Director of the OTS, stressed the deterrent effect of IR35 which would be difficult to quantify:

“The risk would clearly be that if HMRC says that it is suspending IR35 and will not operate any investigations, people might say, ‘Oh, it’s open season, we can do what we like’. We recognised that, so we felt it would be possible to announce the suspension by saying, ‘We are suspending it but not abolishing it, and if we see a marked move up in behaviour that would blatantly be caught by IR35, the suspension will be removed’. That is the risk that we had in mind”.⁸⁷
83. As discussed above, a key question that emerged was whether HMRC’s calculations of the deterrent effect of IR35 (Exchequer protection) are accurate and hence whether abolition would do more harm than good. This underpins Recommendation 1 which calls for a detailed assessment of the Exchequer protection estimates.
84. The Government chose to pursue the OTS’s option of improving the administration of the legislation⁸⁸ and we examine these changes later in this Chapter.
85. We also heard other suggestions in evidence. The IIM suggested that IR35 should be replaced by a straightforward genuine self-employment certification process; a similar proposal was made by David Ramsden of the Federation of Small Businesses (FSB), although such a proposal was not common amongst the wider evidence. There would be clear benefits to such a system, but whether it would apply on a contract by contract basis and the administrative implications of this are unclear. There are clear arguments that people should be free to operate outside conventional employment structures if they wish to do so.⁸⁹ A more difficult question is whether that choice should be conclusive for tax purposes given the tax and National

⁸³ The issue has been a continuous thread in the discussion of tax reform in the United Kingdom and has recently been discussed in a Ten Minute Rule Bill in the House of Commons which had the primary aim of changing the name of National Insurance to Earnings Tax. See HC Deb, 25 February 2014, cols 164–166.

⁸⁴ AAT, CIPP and Contractor Calculator

⁸⁵ *Government Response to the recommendations of the Office of Tax Simplification’s Small Business Tax Review*, 2011.

⁸⁶ PCG

⁸⁷ Q 14

⁸⁸ *Government Response to the recommendations of the Office of Tax Simplification’s Small Business Tax Review*, 2011.

⁸⁹ PCG

Insurance incentives that are on offer to those who operate through a corporate body.

86. A number of suggestions for new ‘rules’, which may act to simplify the process were also made. Amey plc suggested that there might be a case for looking more closely at any engagement which lasted for more than a set period of time; other variants of this principle were also suggested detailing differing timescales. The Giant Group suggested that a minimum number of clients per year could be defined, or that a rule around any one client exceeding a certain percentage of personal service company turn-over could be developed. We were interested to hear from Professor Freedman that a percentage system is used in Australia, though the extent to which this is effective is unclear.⁹⁰
87. **We believe that the abolition or suspension of the IR35 legislation as proposed by the Office of Tax Simplification, whilst attractive, would be unwise if the legislation has the Exchequer protection effect claimed for it by Her Majesty’s Revenue and Customs.**
88. **The current structure and rates of income tax and National Insurance provide an incentive for taxpayers to arrange their financial affairs in order to minimise the amount of tax and National Insurance paid. This has led to complex legislation, such as IR35, to counter such arrangements.**
89. **Whilst we recognise the complexities in merging income tax and National Insurance and the effect that this may have on the contributory principle, we recommend that the Government re-examine the longer term case for combining taxes on income and National Insurance.** (Recommendation 2)

Responsibility

90. In the first draft of the IR35 legislation the onus was intended to rest with the end-user rather than the individual in determining whether IR35 should apply to a contract. The Committee’s Call for Evidence therefore asked: “Do businesses insist on the use of personal service companies? If so, should responsibility be placed on them rather than the worker to decide whether a business transaction falls within IR35?”
91. Currently, the responsibility to take due account of IR35 and associated personal service company legislation rests with the individual who is operating through the personal service company. Efficient and effective tax-collection appears to occur only when the individuals concerned are soundly advised and aware of the complexities involved. For those who do not fall into this category, the expectation that they will declare their status as falling within the intermediaries legislation seems to be rather optimistic as detailed in Chapter five. It has been suggested that the responsibility for assessing IR35 compliance should move from the individual operating through the personal service company to the end-user. The Committee heard that a greater level of responsibility could fall on the engager as was first proposed in the Government’s consultation prior to the introduction of the IR35 legislation. The ICAEW suggested that engagers should bear the responsibility if they insist in engaging an individual through a personal

⁹⁰ Paragraph 131.

service company;⁹¹ others argued that they should be held responsible for any unpaid tax resulting from disguised employment.

92. Although taking this step would remove the responsibility from the individual operating through a personal service company, it would place significant administrative pressure on engaging businesses. The CBI argued that the legal responsibility for determining IR35 status should remain with the personal service company; this view seemed to be shared by most of those from the world of business and was convincingly put to the Committee by GlaxoSmithKline plc (GSK):

“I do not think it would be appropriate for, say, GSK to be accountable for the personal service company paying the appropriate amount of tax. It is a decision made by the worker ... they clearly are aware of what it means to set up a personal service company and so on, so the accountability needs to be with the personal service company. We have no thoughts on how to modify the rules that would change that”.⁹²

Although there are many instances in which businesses undertake elements of the administrative work of collecting taxes such as PAYE and the Construction Industry Scheme (CIS), the majority of the evidence we received did not support placing the onus on businesses to make judgements about whether contracts fall within the IR35 rules.

93. We received much evidence on the questions posed on the various tax return documents, specifically the personal tax return SA100 and the employer tax return P35, which was used before the introduction of Real Time Information (RTI). In the case of the latter, we noted that similar questions must still be answered in the year end declarations made by employers online. In each case, HMRC references ‘service companies’ with questions aimed at detecting activity from both sides of contracting activity, but without a detailed articulation of what ‘service company’ means. The SA100 form defines the term as “a company which provides your personal services to third parties”, but gives no indication that IR35 may need to be considered. Indeed, the guidance note SA150 limits the explanation of what constitutes a ‘service company’ to the following paragraph, again without referencing IR35:

“You provided your services through a service company if:

- you performed services (intellectual, manual or a mixture of both) for a client (or clients); and
- the services were provided under a contract between the client(s) and a company of which you were, at any time during the tax year, a shareholder; and
- the company’s income was, at any time during the tax year, derived wholly or mainly (that is, more than half of it) from services performed by the shareholders personally.

Do not complete this box if all the income you derived from the company was employment income”.⁹³

⁹¹ ICAEW

⁹² Q 110

⁹³ HMRC Document, SA150.

We were of the firm opinion that this was a missed opportunity to raise awareness of the potential tax consequences of operating through a personal service company.

94. We also heard that in many cases the questions were left unanswered. HMRC told us the following:
- “For 2011–12, which is the last year for which we have the data, 1,000 individuals completed the question on the income tax self-assessment return and 120,000 employers answered “yes” to the question on the P35 that they were a service company. Demonstrably, the difference between the two figures and the difference between the 1,000 and the 200,000 figure, which we estimate as the number of personal service companies, demonstrates that the number of people completing the question on the income tax self-assessment return is extremely low. We believe that is for a number of factors: in some cases ignorance, in some cases a conscious decision not to complete”.⁹⁴
95. When asked about the purpose of the question, HMRC told us that although they may consider any lack of completion as a risk indicator, they do not see it as a “key question”⁹⁵ that would render the individual liable to penalties for an incorrect completion. We did not understand HMRC’s rationale for asking questions on the tax returns but not considering their completion as important or insisting that taxpayers complete them.
96. HMRC’s role in advising the tax-payer of the risk of a particular engagement falling within IR35 through their Contract Review Service and in delivering a judgment after an investigation was a constant feature of the evidence given to the inquiry and is discussed in more detail in the following Chapter. Professional Passport, a membership body operating across the flexible workforce sector, stated that the majority of individuals now operating through personal service companies were more aware of their responsibilities than before. It is clear that whoever bears the responsibility for judging whether IR35 applies needs to be soundly advised and well informed.
97. **We acknowledge that businesses would generally resist being made responsible for IR35 assessment, finding the additional administrative pressure and liability as overly burdensome.**
98. **We recommend that Her Majesty’s Revenue and Customs look again at whether they require complete and accurate responses to the “service company” questions on the personal tax return SA100 and the RTI employer year end declaration (formerly P35).** (Recommendation 3)
99. **If Her Majesty’s Revenue and Customs decide that they need the information from those questions, we recommend that their completion should be made compulsory, backed up by the potential for penalties to be charged for incorrect answers or non-completion.** (Recommendation 4)
100. **If Her Majesty’s Revenue and Customs retain the questions, we recommend that they revise the guidance notes accompanying the personal tax return SA100 and the RTI year end declaration by**

⁹⁴ Q 118

⁹⁵ Q 118

employers to make the relationship to IR35 clearer.
(Recommendation 5)

101. **If Her Majesty's Revenue and Customs decide that they do not need the information gained from the questions, we recommend that the questions be removed from the tax returns and declarations.**
(Recommendation 6)

CHAPTER 4: HMRC'S ADMINISTRATION AND THE EFFECT OF RECENT REFORMS

Introduction and Background

102. Over the course of our investigation, we heard from a wide range of witnesses who believed that there were significant problems with the administration of the IR35 legislation. The decrease in the number of annual investigations from over 1,000 a year in the tax years 2002–04 to only 256 in the tax year 2012–13⁹⁶ was noteworthy, and the vast proportion of respondents and witnesses called for a greater emphasis in aiding understanding, either of IR35 generally, or of new resources to support understanding and assessment.
103. In light of HMRC's own estimate of the personal service company population being in the region of 200,000,⁹⁷ it is understandable that they might be unable to investigate all the cases in which there may be a medium or high risk that IR35 might apply, particularly as it must be considered on an individual contract basis. Furthermore, HMRC maintain that the overall size of the personal service company population does not help in targeting those who may fall into the higher risk categories.⁹⁸ Although we were told that risk profiling informs their compliance investigations, the number of people HMRC have assigned to the compliance task (40 at the last estimate) and to the Contract Review Service (three people who also staff the IR35 helpline)⁹⁹ seems rather low when compared with the overall number of operating personal service companies.¹⁰⁰ When this is viewed in the light of a falling number of annual investigations, it seemed to us that IR35 is currently of greater value to the Exchequer as a deterrent measure rather than as a measure which is designed to provide a yield simply through voluntary compliance. This is supported by HMRC's estimate of £520m as the Exchequer protection, a figure more than 17 times that of the actual yield collected from IR35.
104. There is a danger, however, that the value of this protection will diminish if taxpayers believe that HMRC are not willing or able to risk profile effectively in order to inform their compliance investigations. As has previously been noted, the value of the legislation hinges on the credibility of the Exchequer protection figure provided by HMRC; anything which has the potential to reduce this figure should be closely monitored.

Enforcing the legislation

105. Increased activity on the part of HMRC was called for by a variety of bodies including the ACCA, the FCSA, the IMA and the CBI, though there was no

⁹⁶ Q 3

⁹⁷ Q 1

⁹⁸ Q 2

⁹⁹ Q 8

¹⁰⁰ It should be acknowledged, however, that HMRC maintain that enforcement and compliance staff are not deployed to individual tax regimes and so there is no tangible way of accurately measuring proportionality in this respect. Q119 and National Audit Office HM Revenue & Customs 2012–13 Accounts, Report by the Comptroller and Auditor General, R31.

consensus surrounding the degree to which they believed efforts should be scaled up. Conversely, the PCG suggested that compliance and enforcement activity should not be increased until further steps have been taken to improve the clarity of IR35, arguing that an unacceptable ambiguity still remains and that suspension of the rules is the best short-term remedy.¹⁰¹

106. The IoD and CBI suggested that although HMRC had sufficient legislation at their disposal to address these matters, they had dedicated insufficient resources for the task at hand. The FCSA suggest that IR35 is now operating as effectively as it has been for some time, and that the key challenge is to enforce the legislation robustly and effectively. However, the Committee were told by HMRC that they plan to continue with roughly the same number of investigations as they have conducted in the recent past: “Currently we broadly intend to maintain compliance coverage i.e. around 250 cases per annum, as we did last year and have done for the current year”.¹⁰²
107. In opposition to this light-touch policy, David Kirk, a Chartered Accountant and Chartered Tax Adviser who specialises in the intermediary sector, argued that for IR35 to have a deterrent effect, HMRC would need to conduct in the region of 10,000 enquiries per year, as opposed to the 250 that they are currently aiming to undertake, and that the resources to deliver this level of activity would not be realistically available. Once again the deterrent effect of IR35 was cited as important.
108. Professional Passport suggested that focusing on the enforcement of existing legislation with fast, robust, visible and effective action would result in much greater returns for HMRC as well as raising the level of compliance. They argued that HMRC must be put in a position where it can act and react as quickly as the market. The FCSA believed that enforcement, rather than reform, was required and G4S plc argued that IR35 is technically sound, when understood and applied correctly. The twin issues of a need for clarity and a greater effort to enforce the existing legislation were recurring themes in the evidence we received.
109. HMRC told us about the recently increased resources available to them for this operation:
- “Our compliance interventions are done by our specialist employer compliance teams. There are now four teams, totalling 40 people, who spend not all but a substantial amount of their time on IR35 cases, and they work on other broader employment and avoidance risks. Those 40 people are part of a much broader employer compliance field force that look across employers more generally, including other intermediaries such as umbrella companies and managed service companies”.¹⁰³
110. In opposition to much of the evidence we received however, they did not hold that increased resources would be of much benefit. In response to a question about how extra resources would be used, we were told:
- “I do not think we would want to make a direct correlation in that way. It is not simply about increasing the resources because, as I say, I do not

¹⁰¹ PCG

¹⁰² Q 3

¹⁰³ Q 121

think there is necessarily a direct correlation between the resources you invest and the effectiveness, particularly in this sort of area. I think a lot of it is about the quality of the interventions and the way we target them and run our interventions”.¹⁰⁴

111. It was also regrettable that HMRC were unable to provide precise costing for the current compliance and administrative work that directly relates to IR35. We were told that spending on the current compliance team of 40 people costs approximately £700,000 a year, a team which collected £1.1m in 2012–13 as a result of uncovering non compliance with IR35. HMRC, however, made it quite clear that these individuals work as part of a much broader employer compliance field force which works with legislation other than IR35.¹⁰⁵ In light of the 2011 report of the House of Commons Treasury Select Committee on Principles of Tax Policy,¹⁰⁶ we felt that the overall practicability of the tax measure and the value for money that it delivers for the taxpayer needed to be further articulated by HMRC. Concrete figures of how much the IR35 rules cost to enforce and administer were not forthcoming; consequently, a cost-benefit analysis of HMRC’s compliance activity could not be carried out.
112. **Her Majesty’s Revenue and Customs did not convince us that the resources currently allocated were sufficient to ensure compliance with the IR35 legislation.**
113. **We recommend that Her Majesty’s Revenue and Customs articulate with greater clarity the costs they incur from IR35 compliance efforts and administration, and the relationship between those costs and the overall yield gained from the legislation.** (Recommendation 7)
114. John Whiting made the point that IR35 was never fully intended to be enforced:
- “I have always felt that IR35 was never actually designed to be used, in the sense of really being applied. In many ways the intention was that people would recognise that they were caught and say, “Okay, it’s a fair cop; I will go back on the payroll”, but that rather missed the point—we are back to my push and pull—that people were often being pushed off the payroll. My point is that when IR35 was designed in 1999–2000, to me the way in which it was going to be applied and policed was not really thought through because it was rather expected that the deterrent, to come back to your term, would be sufficient; everyone would be back on the payroll and, frankly, we would not be sitting here”.¹⁰⁷
115. We heard that the time taken from opening to closing an IR35 investigation had been dramatically reduced. Taking on board the points made in the OTS review that external stakeholders were often concerned about the length of time taken to complete an investigation, particularly where it was discovered that there was no liability, HMRC told us that:

¹⁰⁴ Q 122

¹⁰⁵ Q 121

¹⁰⁶ Treasury Select Committee, *Principles of Tax Policy* (8th Report, Session 2010–11, HC 753). Written evidence from the ICAEW suggested that in their estimation, IR35 fails on seven of the ten tenets highlighted in this report.

¹⁰⁷ Q 15

“In 2012–13, for cases that we opened since April 2012, it took 28 weeks on average from opening to closing a case. That compares in earlier years to 110 weeks and over 140 weeks ... we are very committed to dramatically reducing the intervention time”.¹⁰⁸

Professional Passport claimed to have seen inquiries closed quickly where contractors provided evidence of professionally carried out assignment reviews that HMRC accepted, although the quality of these professional reviews varied widely. They considered this a positive development.

116. Furthermore, we were assured that investigations are targeted across a wide range of employment sectors: “We constantly reflect on whether we are properly targeting our inquiries and the extent to which we should be looking at particular areas and particular skill sets”.¹⁰⁹ The reduction in the average investigation time of cases believed to fall within IR35 and the broad scope of targeting is clearly a positive step forward.

Taking the Risk

117. Angela Williams, a Chartered Accountant and Chartered Tax Adviser, stated that many now take the chance that they won’t be investigated by HMRC.¹¹⁰ This willingness to take a risk suggests that the deterrent effect of IR35 is diminishing. Professional Passport echoed this sentiment, considering that their estimates of 200,000 personal service companies and only 250 IR35 investigations a year suggested that the majority of contractors would still be prepared to take the risk and base their decisions and behaviour on being outside IR35. The Giant Group suggested that the assignment by assignment, contract by contract nature of IR35 made it inefficient, and also effectively impossible to police by HMRC. This might mean that some will take the risk of not being caught. John Whiting told us that “People hear in the pub or golf club, ‘Oh, you don’t need to worry about it. You just do such and such’. I think HMRC is beholden to do all that it can to alert and to raise IR35’s profile”.¹¹¹
118. We were told about the growing prevalence of ‘IR35 proof’ contracts and the numbers of private review services which profess to give individuals assurances that their contractual arrangements are not caught by IR35. Whilst a market has grown up around the provision of these supplementary supports, we heard that the quality and reliability of the advice provided by different companies varies.¹¹²
119. Witnesses¹¹³ told us that HMRC’s Contract Review Service, a telephone helpline established to advise individuals of the likelihood of a particular contract falling within IR35, was not widely known about and was often approached with a certain degree of suspicion and trepidation; there was a fear that a case brought to HMRC for advice might be later reported to the IR35 case investigation team and the individual might thus become the subject of a formal investigation. Kate Cottrell told us that:

¹⁰⁸ Q 6

¹⁰⁹ Q 7

¹¹⁰ The same comment was also made by Giant Group, written evidence.

¹¹¹ Q 14

¹¹² Professional Passport

¹¹³ Q 28

“On the contract review service there is a huge lack of trust of HMRC ... There have been some articles in the contractor press recently saying, ‘Whatever you do, do not send your contract to the Revenue’. The problem is that because the Revenue is still working with the original legislation, it is asking to do things when reviewing a contract that there is no time to do. They want you to have signed the contract first, whereas most people, when they have a contract, want to know what is in it, what is bad, what they want to change, and whether it is properly reflective of the relationship. There is quite a lot of work to be done on the contract review service to get people to use it, if indeed they would”.¹¹⁴

120. The ICAEW suggested that the Contract Review Service should be publicised to greater effect,¹¹⁵ and that further guidance for non tax specialists should be introduced. The IMA suggested that IR35 briefing information could be sent out, alongside new company forms, by Companies House, and G4S plc suggested that more could be done to raise awareness of IR35 amongst small businesses. The FCSA felt that HMRC should be more ‘opinionated’ in stating what constitutes good and bad practice,¹¹⁶ and that they should seek to exert more influence over end-users and agencies.
121. It was encouraging to hear that HMRC were aware of the suspicion that surrounds the Contract Review Service and that they maintain the independence of the helpline from the compliance teams, though little appears to have been done to assure concerned parties:
- “We are looking again at the contract review service to better understand why it is not used more widely. Part of that may be that people are not aware of the service, but part of it may also be that people are worried about its confidentiality, although I assure the Committee, as I assure everyone, that it is confidential and that the team operating the helpline and the contract review service are quite separate from our compliance team, so information is not shared”.¹¹⁷
122. **We conclude that many individuals simply take a risk that Her Majesty’s Revenue and Customs will not look into their employment status, an attitude that is fostered by the decreasing number of compliance investigations.**
123. **We recommend that the Contract Review Service be publicised to greater effect, that Her Majesty’s Revenue and Customs investigate ways to encourage individuals to use the service and that they look into ways to bolster confidence in its independence and impartiality.** (Recommendation 8)

Recent reforms: The Business Entity Tests and the IR35 Forum

124. There was a general consensus that there is insufficient guidance provided by HMRC for those who operate through personal service companies. The introduction of the Business Entity Tests (BETs) and the establishment of the IR35 Forum have generally been seen as positive steps in improving

¹¹⁴ Q 28

¹¹⁵ ICAEW

¹¹⁶ Q 61

¹¹⁷ Q 10

guidance and channels of communication with interested stakeholders. We heard, however, that there is still more to be done.

125. The BETs were published by HMRC in May 2012. The 12 tests are contained within a document which also includes case studies and an explanation of the risk based approach that lies behind the tests. HMRC make quite clear in the publication that the scoring from the completion of the tests provides an indication of risk, not a concrete judgment on whether an engagement lies within the IR35 legislation. The tests cover the following areas: business premises; professional indemnity insurance; efficiency; assistance; advertising; previous PAYE; business plan; repair at own expense; client risk; billing; right of substitution; and actual substitution. Each test asks at least one question and a 'yes' answer scores points. Different tests give different scores and the individual adds up the points at the end of the tests. A score of less than 10 is categorised as high risk, more than 20 as low risk and the scores in between as medium risk. The 'yes' scores range from 35 for the assistance test to one for the business plan test. The questions asked in the tests require the individual to look at various features of their engagements.
126. Some respondents were encouraged by recent attempts on the part of HMRC to improve administration in this general area. The FCSA felt that the changes introduced in 2012 were encouraging, with improved guidance, the focused IR35 helpline, revised organisational approach and the introduction of the BETs. John Whiting felt that the BETs had had a positive impact; whilst not offering complete certainty, they allowed contractors to secure a relatively quick in/out take on IR35:

“My sense is that they have had a positive impact: they do not deliver absolute certainty to the taxpayer, but that is probably impractical (as circumstances change). There are also a lot of factors which no doubt appear complex and long to the personal service companies user but we are in an involved area. I feel that in the great majority of cases they will serve to give a quick and reliable 'in'/'out' answer, if approached with reasonable knowledge of what is going on”.¹¹⁸
127. Since their publication however, the BETs have been met with various forms of criticism. Although some have expressed how useful they find them in clarifying which type of contracts are caught by IR35 and which are not, others have expressed their strong opinion that they simply add another layer of confusion. The Recruitment and Employment Confederation (REC) told us that that the tests are ordered so as to necessitate a greater deal of work on the part of the individual. In their opinion a simple reordering could mean that on the consideration of the first two tests (the assistance test with a 'yes' score of 35 and the actual substitution test with a 'yes' score of 20), the individual is immediately highlighted as being of low risk.¹¹⁹ The BETs have been discussed in the IR35 Forum but there is disagreement on whether or how they should undergo substantive reform.
128. Kate Cottrell noted that the BETs were only a test for IR35 risk, rather than IR35 applicability; this understanding was not always present amongst those using the tests: “The problem with the business entity tests really is that they

¹¹⁸ John Whiting

¹¹⁹ REC

are being used as a status test. All the business entity tests are actually saying is, “What is your level of risk of investigation for IR35?”¹²⁰ This point was echoed by APSCo who cited their wider use within the public sector:

“If APSCo could change one thing, it would be the business entity tests ... the weighting of those tests means that they are ultimately now not being used as a risk identifier, which is what they were originally there for—a filter of risk. We are particularly concerned that within the public sector, many departments are using the business entity tests as a way of deciding whether somebody is in or outside of IR35, because of the guidelines from the Treasury on payroll arrangements”.¹²¹

There is certainly room for an increased emphasis on the part of HMRC that the use of these tests is only to be seen as a guide as to whether a case falls within the IR35 legislation or not.

129. John Whiting pointed out that the document detailing the tests is not easily accessible to those who may be searching for it online: “It is instructive to search HMRC’s site. A search for ‘IR35’ and ‘IR 35’ (i.e. with a space between IR and 35) returns different things; neither search immediately turns up the ‘Business Entity Tests’ document”.¹²² Digital by default as a wider Government policy was also the subject of discussion, with evidence being provided that certain groups of people may not be able to access the necessary information online.¹²³ HMRC told us that work was underway on this issue in the IR35 Forum;¹²⁴ there is clearly more work to be done in making the tests more accessible.

130. Both the FSB and the REC were of the opinion that the BETs have added more confusion than clarification over whether a contract falls within or without IR35. The PCG also argued that the tests require revision, suggesting that they are too sensitive to small changes in the circumstances of an individual and that the scoring of the tests is unrealistic and unfair:

“I would like to see these tests refined, assuming IR35 is not to be repealed or suspended. PCG, at the time, proposed a different scoring methodology, which I think would make things a lot clearer. We proposed a further six questions on top of those that were adopted, which, again, I think would be a useful addition. PCG feels very much that IR35 itself can be refined to a certain extent”.¹²⁵

131. An alternative approach to case by case examples as provided in the 47 page BETs document was explained by Professor Judith Freedman, who shared the Australian approach with the Committee. That system did not receive unqualified support from Professor Freedman:

“There is an 80% test, so that, essentially, if at least 20% of your work comes from other than one client, you will have a safe harbour. You have some definite lines in the sand. However, I do not think it is working brilliantly well ... As soon as you provide a very clear line in the

¹²⁰ Q 28

¹²¹ Q 61

¹²² John Whiting

¹²³ Q 26 and Q 40

¹²⁴ Q 9

¹²⁵ Q 55

sand, some people—not everybody—will game that line. There is a tension between having a very clear rule, which is helpful for the majority of people, and stopping avoidance. I would not say that the Australian system is simple. I went to check it before I came here, and the basic booklet to explain it to people is 64 pages long”.¹²⁶

132. We were encouraged to hear that HMRC are aware of the dissatisfaction with the BETs, a view that has been made clear by the work of the IR35 forum,¹²⁷ and that a review is being considered:

“Feedback has been mixed. Some people say that they find the business entity tests, which were launched at that time with case studies, useful, but we have also had a lot of feedback through the IR35 Forum that people are not happy with them and they are being used wrongly as an unemployment status test or being manipulated to contrive a score ... [The BETs] were only ever intended to provide a guide to the likely risk that they would be within IR35 or the risk of having an IR35 compliance investigation, so they were developed with the IR35 Forum as an attempt to give contractors greater certainty in IR35, because we were conscious that one of the criticisms of IR35 was that it caused uncertainty ... When we introduced them, we made it clear on our website that we were piloting these and that we might come back to them and update them. Indeed, we are now looking at them again as part of our review of all the processes that were introduced as a result of the OTS review. That will include us looking at the business entity tests to see if they are fit for purpose or whether they could be improved to be more useful”.¹²⁸

133. **We accept that the guidance will never be able to give absolute certainty to taxpayers of their status in relation to IR35 but we agree that the current guidance is far from satisfactory.**

134. **We recommend that Her Majesty’s Revenue and Customs undertake a full consultation on how the Business Entity Tests could work better to provide greater certainty for taxpayers.** (Recommendation 9)

135. Views on the IR35 Forum were mixed. John Whiting praised the work of the IR35 Forum which was founded following the 2012 OTS Small Business Tax Review. Talking of the collective responsibility that lies at the heart of improving the BETs, he told us:

“I think it is the responsibility of us all ... to get the Revenue, the Treasury, business representatives and small business advisers working together—and I think that that remains the way forward on these tests. If advisers find problems with one or more of the tests, those ought to be fed in and discussed in the forum, and the tests ought to be refined”.¹²⁹

136. HMRC told us that they saw the IR35 Forum as invaluable in improving the service that they offer to the taxpayer:

“One of the things that we are doing through the IR35 forum—in truth, possibly for the first time—is trying to see matters from the taxpayer’s

¹²⁶ Q 28

¹²⁷ Q 9

¹²⁸ Q 9

¹²⁹ Q 17

perspective, and we are doing that through members of the Forum who represent the accountancy profession, contractors themselves and the recruitment sector. We are asking them how their members, or their accountancy bodies, feel we are communicating people's tax obligations and reporting requirements, and we are trying to amend our guidance, and possibly in due course even the wording on our statutory returns, accordingly to try to make things easier for people to understand".¹³⁰

We were also interested to hear that HMRC are working with the IR35 Forum to investigate why the completion rates on the various tax returns are so low,¹³¹ a problem which is addressed by some of our earlier recommendations.¹³²

137. The ACCA saw the Forum as a positive step forward, but suggested that the work of the group was constrained by its terms of reference. In their view, limiting discussion to IR35 meant that wider, relevant issues about personal service companies more generally could not be addressed. The ICAEW thought that the Forum worked well in developing new guidance, but that the work of the group was limited by the poor body of legislation within which it was working.
138. Despite the positive attitude of HMRC, a number of written submissions reported an element of resistance.¹³³ The REC explained that, within the forum, they had consistently requested that the BETs be updated and that the associated guidance be improved, but had seen no change in HMRC's approach. The IIM felt that the Forum should have a wider stakeholder membership and that there should be a greater level of assurance that topics discussed had been taken on board by HMRC. The PCG felt that the Forum had failed to produce meaningful change and that, more generally, deliberations were hampered by a lack of data availability from HMRC. David Ramsden from the FSB echoed this sentiment:
- "I too sit on the forum, and I have to say that I get the distinct impression that the Forum is there, largely, as a box-ticking exercise. It would not be if HMRC took any notice of what the external members of the Forum had to say".¹³⁴
139. **We commend the motive behind establishing the IR35 Forum as an opportunity for wider stakeholder engagement.**
140. **We recommend that Her Majesty's Revenue and Customs go to greater lengths to demonstrate that they are receptive to the feedback that is provided through this group and that they review the breadth of membership.** (Recommendation 10)

¹³⁰ Q 11

¹³¹ Q 118 and Q 124

¹³² Recommendations 3–6.

¹³³ AAT and CIPP

¹³⁴ Q 61

CHAPTER 5: IMPLICATIONS FOR THE LOWER-PAID

Introduction and Background

141. The use of personal service companies is often associated with high-skilled, higher paid professions. Much of the analysis presented elsewhere in this report considers the use of personal service companies by freelance professionals such as senior executives, IT software development specialists and oil industry engineers.
142. Our evidence suggested that the use of personal service companies was not limited to these relatively well-remunerated professions. We were told that receptionists, office workers, credit controllers, healthcare workers, telephonists and cleaners had been asked to provide their services through personal service companies.¹³⁵ ACCA stated that HMRC enquiry work had established that there was a “significant problem” with abuse of corporate forms in the lowest paid sectors with engagers in the hospitality sector, for example, looking to establish chamber maids in their own personal service companies.¹³⁶ HMRC stated that personal service company use extended across all income ranges and across all sectors.¹³⁷
143. The use of personal service companies across a diverse range of sectors and income levels can, in some part, be considered a consequence of the growth of the flexible workforce in the UK. The FCSA told us that the flexible workforce totals between 1.5 million and 2 million workers;¹³⁸ the Office for National Statistics (ONS) estimates¹³⁹ that 4.37 million people in the UK are self-employed, and that there are just over 1.6 million temporary workers in the UK.¹⁴⁰ The flexible workforce extends from low paid, low skilled people at the one end, to highly paid, highly skilled individuals trying to run a business on their own account at the other end.¹⁴¹ The CBI gave the following explanation for this growing phenomenon:
- “As we saw in the debate about zero hours contracts, which is another form of labour flexibility, part of that growth is about companies being unable to predict demand. A second potential structural point is that companies are increasingly feeling competitive pressure across a large number of sectors. One of the ways in which companies have looked to allow for that competitive pressure is to align more closely labour input to demand, and clearly more flexible forms of employment allow that. I do not think it is a surprise that we have seen a growth in flexible forms of employment generally”.¹⁴²
144. There has been little analysis of the different forms of flexible employment. Whilst we received evidence that some lower paid individuals are engaged

¹³⁵ Angela Williams, written evidence and Frances Corrie (Q82).

¹³⁶ ACCA

¹³⁷ Q 123

¹³⁸ Q 48

¹³⁹ Figures for October to December 2013 (published in February 2014). See: http://www.ons.gov.uk/ons/dcp171778_350998.pdf

¹⁴⁰ *Ibid.*

¹⁴¹ FCSA

¹⁴² Q 94

through personal service companies, we were told that the number of such people engaged through limited companies had fallen since the implementation of the managed service companies (MSC) legislation in the Finance Act 2007.¹⁴³

145. Martin Hesketh of the FCSA told us that the managed service companies legislation had changed the working structures of “tens of thousands” of people, by ensuring that those working through limited companies have to take on directly the responsibilities of ownership, directorship and management. The net result of this had been to push low paid individuals—who did not want or were not able to manage these responsibilities—out of the limited company arena.¹⁴⁴ The ICAEW and Contractor Calculator echoed this view.¹⁴⁵
146. Lower paid people are, of course, prominent amongst the flexible workforce. Umbrella companies figured significantly in the evidence that we heard. They provide a vehicle through which members of the flexible workforce can offer their services without having to incorporate individually. The umbrella manages invoicing, payroll and contract matters, and pays the worker via PAYE. The individual is employed by the umbrella, rather than the end-client. Individuals are given an over-arching contract of employment, which allows them to work in different positions, with different end-clients.
147. Frances Corrie, of TaxAid, a charity that helps people on low incomes with their tax affairs, told us that she dealt with significant numbers of lower paid individuals who were engaged through umbrella companies. Example occupations included security guards, couriers, drivers, cleaners and chefs.¹⁴⁶
148. Agencies also figured prominently here; we heard that agencies provided workers through a variety of engagement methods, including personal service companies. Often, agencies worked alongside umbrella companies to deliver flexible workers, with the agency liaising with and sourcing end-clients and the umbrella paying wages, PAYE and managing invoices. The Institute of Chartered Accountants of Scotland (ICAS) told us that there was “widespread referral of low paid workers to umbrella companies by agencies”.¹⁴⁷
149. The evidence we received identified issues surrounding the circumstances in which lower paid individuals are engaged—whether through personal service companies, umbrellas or by agencies. The remainder of this Chapter considers the extent of these complex problems.

Issues for the lower paid

Reduced entitlements

150. It is clear to us that where lower skilled workers within the flexible workforce are employed through the use of corporate forms, including both personal

¹⁴³ See Chapter two for more detail on the managed service companies legislation.

¹⁴⁴ Q 48

¹⁴⁵ ICAEW and ContractorCalculator

¹⁴⁶ Q 82

¹⁴⁷ ICAS

service companies and umbrella companies, they generally have lower entitlements compared with those in permanent employment.

151. The Low Incomes Tax Reform Group (LITRG) suggested that the scope for potential exploitation was considerable, noting that many migrant workers, who are often unclear about their rights and responsibilities, find themselves providing their labour through corporate forms.¹⁴⁸ This work was often delivered through umbrella companies, working with agencies, although the LITRG had also seen personal service company use promoted on the internet, with some advertising of personal service company use “clearly aimed at migrant workers”, offering to provide a UK registration address and mail forwarding service.¹⁴⁹
152. The National Association of Schoolmasters Union of Women Teachers (NASUWT) told us that the overwhelming majority of supply teachers deliver their work through agencies and umbrella companies. They were clear in their view that the main beneficiaries from these arrangements were the agencies and umbrellas themselves, rather than the individuals engaged through them, concluding that “we feel there are groups of workers here that are being quite seriously exploited”.¹⁵⁰
153. The issues at play differ slightly, depending upon which intermediary vehicle is used. For any low-paid individuals using a personal service company, the drawbacks would be much the same as they would for a professional contractor; lack of holiday pay, sick pay, paid training and the absence of various rights and protections such as maternity leave and working time protections. It is unlikely that these individuals would benefit from workplace pension provision. Whilst these are features of a non-permanent workforce, there would be an issue of exploitation if the individual in question was unaware of these consequences and had been pushed into the personal service company arrangement without any proper alternative being made available.
154. Individuals engaged through an umbrella company would benefit from many of the statutory rights and entitlements mentioned above, as they would have a contract of employment with the umbrella. These rights and entitlements would be more than those available if a personal service company were used but would typically be less than those available in a conventional employment relationship. They would, however, be exposed to a slightly different set of issues. One such problem is the potential over-inflation of tax deductible travel expenses, which might be encouraged by the umbrella and for which the individual might be liable if subjected to a HMRC investigation. This is discussed in more detail in paragraph 174 below.
155. Other issues cited included the charging of fees for the work of the umbrella company, which were debited from the salary of the individual,¹⁵¹ gaps in National Insurance contribution records¹⁵² and employers’ National Insurance contributions being deducted from gross amounts available to pay

¹⁴⁸ LITRG

¹⁴⁹ *Ibid.*

¹⁵⁰ Q 82 and NASUWT

¹⁵¹ Cited by LITRG, AAT, CIPP and Sue Christensen, all in written evidence.

¹⁵² LITRG

salaries.¹⁵³ The documentation associated with engagements through umbrellas and agencies did not always clearly set out gross pay rates, contributions and fees, inhibiting awareness of these potential issues.¹⁵⁴

The issue of awareness

156. The ICAEW told us that, whilst higher paid individuals may choose to deliver their services through a corporate form, there were many more lower paid individuals who had little choice over the matter and who were compelled to operate through a personal service company or an umbrella.¹⁵⁵ HMRC acknowledged this, stating: “We are seeing a number of cases where personal service companies are being used at low income levels and, indeed, that people are being—for want of a better term—pushed into these service companies”.¹⁵⁶ It is important to note that we saw limited evidence of this push coming from the end-clients themselves; instead, it appeared that any pressure to work in this way came mainly from employment agencies through which the individuals sought work.¹⁵⁷
157. We were told that some individuals were being forced into delivering their labour through vehicles which they didn’t fully understand, with the reality of the situation only becoming apparent when the worker seeks to access benefits or exercise rights.¹⁵⁸ John Whiting told us that “the unadvised, or the person who is forced into a personal service company or umbrella route, is another matter. They may be hazily aware of something lurking but may not appreciate the full impact”.¹⁵⁹
158. These individuals can sometimes become confused when it comes to determining by whom they are actually employed. Neil Carberry, of the CBI, told us that there were issues in parts of the labour market with employees and workers not understanding the status on which they had been engaged.¹⁶⁰ Frances Corrie explained that: “The confusion increases because often, particularly at the perhaps less educated end of the labour market that we see, if you ask people who they are working for they would name their end user. That is where they work”.¹⁶¹
159. The LITRG told us that the documentation and payslips associated with flexible employment structures for lower paid individuals were often complex, compounding the issues caused by a general lack of information and clarity.¹⁶²
160. We believe that these issues are a cause for concern. It is apparent that some individuals are engaged in or through corporate forms which they don’t fully understand and that, in some cases, to engage in this way may not entirely have been the choice of the individual concerned. This lack of awareness

¹⁵³ ICAEW, LITRG and NASUWT

¹⁵⁴ Q 84

¹⁵⁵ ICAEW

¹⁵⁶ Q 123

¹⁵⁷ This is in part due to the Agency Regulations, discussed in Chapter two of this report.

¹⁵⁸ Angela Williams

¹⁵⁹ John Whiting

¹⁶⁰ Q 96

¹⁶¹ Q 83

¹⁶² LITRG

gives rise to the opportunity for potential exploitation by end-clients and the operators of umbrella companies and other intermediaries. In addition, it is possible that the individuals concerned are unaware of their potential exposure to issues relating to statutory entitlements, pensions and employment rights; for many, the distinction between employment and engagement is unclear. The fact that employment law does not always directly equate to tax law makes the situation still more complex to the uninitiated.

161. Solutions to these complex issues are not immediately obvious. The LITRG told us that a small number of well targeted investigations into the purveyors of schemes would make a difference.¹⁶³ It was also suggested to us that understandable, concise, information about the differences between employment and self-employment should be made available to all individuals working in industries where intermediary vehicles were prevalent.¹⁶⁴
162. The production of such information would not be without difficulty, given the complex nature of the subject matter and the reliance on case-law for drawing distinctions between employment statuses. The IoD raised the issue of complexity noting that, whilst engagers could have a responsibility for ensuring that any such guidance was passed on to individuals, the onus should be on HMRC to determine what the guidance should contain.¹⁶⁵
163. **We are concerned that, in some sectors, individuals who are providing their services through personal service companies or, more often, umbrella companies and agencies, have a limited awareness of how they have been engaged to provide their work and who it is that has engaged them. This may mean that the individuals are not aware that they have foregone at least some levels of employment protection and benefits to which they would be entitled if they were in conventional employment. We recognise the complexity of the subject matter, and of the case law underpinning some of the distinctions made, but believe that it ought to be possible to present these issues in a concise and understandable manner.**
164. **We recommend that the Government should develop and publish a short guide setting out the basic differences between employment and self-employment. The guidance should be published across multiple platforms, including both digital and paper, and should be made available to individuals working in all industries where intermediaries are prevalent.** (Recommendation 11)

A role for the Low Pay Commission?

165. A major issue hindering any attempt to propose solutions to the issues raised in this Chapter is the lack of clear robust information and analysis about the scale of the problem. Estimates for the flexible workforce in general are available (see paragraph 143) but, as detailed previously, this is not a homogenous group and will include individuals at the higher end of the income spectrum, as well as those who are lower paid.

¹⁶³ LITRG

¹⁶⁴ *Ibid.*

¹⁶⁵ Q 96

166. Major employers from whom we heard had little detailed knowledge about the circumstances of flexible workers at the lower end of the income scale. Almost all used agencies to secure such labour, but were usually unclear about the methods of engagement used between the agencies and the workers they provided.¹⁶⁶
167. HMRC admitted that they were unclear on the true extent of low paid individuals who might be engaged specifically through personal service companies, stating that they “do not have enough information on the numbers of people at the lower salary level to come to a view as to our best strategy”.¹⁶⁷ HMRC acknowledged that there may be circumstances in which lower paid individuals, engaging through personal service companies, did not understand the implications for statutory entitlements and, also, where the liabilities for tax and National Insurance might fall.¹⁶⁸
168. We asked HMRC what more they could be doing to tackle any exploitation of lower paid individuals engaging through personal service companies. They took the view that, in some of these cases, the engagements might actually be through managed service companies, rather than personal service companies and, if that were the case, the managed service companies legislation should apply. For those affected who were engaged through personal service companies, HMRC suggested that they needed to develop a communication strategy that raised awareness of the issues involved. These approaches came, however, with a caveat that more information was required before HMRC could determine the best route forward.¹⁶⁹
169. We believe that the Low Pay Commission (LPC) could have a role to play here. The LPC is an independent, statutory, Non-Departmental Public Body set up under the National Minimum Wage Act 1998 to advise the Government on the national minimum wage and related matters. The Commission’s stated goal is to recommend “levels of the various minimum wages which help as many low-paid workers as possible without any significant adverse impact on employment or the economy”.¹⁷⁰
170. The Commission produces an annual report, the principal purpose of which is to make recommendations about future minimum wage levels. This report takes its lead from an annual remit for the Commission, issued by the Secretary of State for Business, Innovation and Skills. The remit can request the Commission to include, in its report, advice on particular areas of concern or interest.
171. We believe the developing use of corporate intermediaries to engage lower paid individuals in work is worthy of examination by the LPC. The Commission has the capacity and wider expertise to produce more detailed analysis of the effects of the use of personal service companies, umbrella companies and agencies on the circumstances of lower paid workers. This analysis would help to inform HMRC’s approach, which currently suffers from a lack of detailed knowledge. Furthermore, the issues around exploitation and lack of understanding around employment rights that we

¹⁶⁶ Amey plc, LGA, NHS Trust Development Authority, GSK and Crossrail.

¹⁶⁷ Q 123

¹⁶⁸ *Ibid.*

¹⁶⁹ *Ibid.*

¹⁷⁰ LPC Business Plan, 2013–14.

have discussed in this Chapter are likely to have contextual relevance for consideration of the national minimum wage.

172. **We recommend that the Government includes within the remit of the Low Pay Commission a consideration of the use of personal service companies and umbrella companies by lower-paid workers, and the implications for pay, employment rights and statutory entitlements.** (Recommendation 12)

Expenses and enforcement

173. We were told that umbrella companies play a vital role in the supply chain for flexible labour¹⁷¹ and that, operated correctly, they provide an efficient form of tax collection from this element of the workforce.¹⁷²
174. We also heard, however, a significant amount of evidence concerning the way in which umbrella companies managed the expenses of those engaged through them. If an individual working for an umbrella company is engaged on an over-arching contract of employment they are able to claim tax deductible travel expenses covering journeys from home to work. Umbrella companies are able to apply for and operate an expenses dispensation, which allows them to omit relevant expenses from their annual benefit in kind (P11D) returns to HMRC.
175. The LITRG suggested that individuals are often encouraged into the use of umbrella companies by the promise of greater levels of take home pay. They contend that these levels are, in fact, generated by understating taxable pay and overstating tax deductible expenses. Any understatement of pay could lead to a reduction in the value of National Insurance contributions, to the potential detriment of an individual's long term pension entitlements.
176. A number of respondents to our call for evidence raised issues with the manner in which umbrella companies managed expenses dispensations. These included Professional Passport, Sue Christensen (a Partner at Sue Owen Accountants), the AAT and the CIPP, ICAEW, the PCG and the LITRG. The NASUWT told us that they were aware of these issues.¹⁷³
177. HMRC acknowledged that abuse of expenses dispensations by umbrella companies was taking place. They stated that the taxing obligation in these cases would rest with the umbrella company and that, as such, HMRC would seek any tax or National Insurance from the umbrella, rather than the individual worker.¹⁷⁴ Provisions exist, where appropriate, for recovering money personally from the officers of a company, or for transferring liabilities for National Insurance owed to a director of the company concerned.
178. This approach is not reflected in some of the wider evidence that we heard. The LITRG suggested that any investigation into expense abuses by HMRC is likely to result in penalties or problems for the worker, rather than the umbrella company.¹⁷⁵ Professional Passport suggested that when umbrella companies had, in the past, been found to be non-compliant, there had been

¹⁷¹ G4S plc

¹⁷² Professional Passport

¹⁷³ Q 85

¹⁷⁴ Q125

¹⁷⁵ LITRG

“numerous examples where the umbrella shuts its doors and walks away leaving HMRC holding all the losses”. They also stated that they were not aware of any action taken against directors personally to recover any of these losses.¹⁷⁶

179. The NASUWT had little faith in HMRC’s description of their approach, stating:

“We have had some quite astonishing advice from HMRC ... where HMRC said that if that were done it would not be the responsibility of the individual, it would be the responsibility of the umbrella company. I cannot see a circumstance in which somebody who is claiming expenses they have not had does not have some personal liability for this”.¹⁷⁷

180. It is widely acknowledged that some umbrella companies are abusing the expenses dispensations that HMRC allow them to operate. HMRC are aware of this issue and have set out clearly their approach to tackling it, although it is apparent that some confusion as to where liability for any under-payment of tax or National Insurance lies continues to exist. It is possible that this liability might vary, according to the circumstances of individual cases. Notwithstanding this, HMRC must act to ensure that these abuses are uncovered, addressed and deterred through action.

181. **As it is clear from the evidence that abuse of the expenses dispensations operated by umbrella companies is taking place, we recommend that Her Majesty’s Revenue and Customs ensure that enforcement action is taken to end these abuses and to ensure that expenses dispensations are managed correctly.** (Recommendation 13)

182. **We also recommend that Her Majesty’s Revenue and Customs should review its processes for granting and renewing expenses dispensations, in order to ensure that potentially high risk organisations are granted dispensations only when appropriate.** (Recommendation 14)

183. The operation of a personal service company allows for expenses to be set against taxable income. This could, potentially, be another source of abuse. We asked HMRC about this issue, and were told that there was no evidence of widespread abuse of expenses rules by personal service companies.¹⁷⁸ We received no substantial evidence that challenged this position.

¹⁷⁶ Professional Passport

¹⁷⁷ Q 85

¹⁷⁸ Q 125

CHAPTER 6: THE PUBLIC SECTOR

Introduction and Background

184. The use of personal service companies (and other ‘off-payroll’ arrangements) by the public sector came to prominence in 2012 following a Freedom of Information request concerning the appointment of the Chief Executive of the Student Loans Company. The Chief Executive was first appointed on an interim basis in May 2010; a subsequent 2-year contract was finalised in December 2010, following a competitive recruitment process. Both of these appointments were made through the Chief Executive’s personal service company.
185. On 31 January 2012, following media coverage of this case, the Chief Secretary to the Treasury, the Rt Hon. Danny Alexander MP, commissioned a review to examine the extent of off-payroll arrangements in central Government.¹⁷⁹ The aim of the review was to ascertain the extent of arrangements which could allow public sector appointees to minimise their tax payments, and to make appropriate recommendations. The review found that 2,400 staff earning more than £58,200 a year were engaged off-payroll in central Government and arms length bodies. Senior management positions accounted for around 5% of these cases.¹⁸⁰
186. The review was published on 23 May 2012. At the same time, the Chief Secretary announced various changes to departmental practice when ‘off-payroll’ appointments were agreed.¹⁸¹ These included:
- A presumption that the most senior staff must be on the payroll, unless there are exceptional temporary circumstances. Any such circumstances would require Accounting Officer sign-off, and can last no longer than six months.
 - For appointments of contractors lasting longer than six months and costing over £220 per day, all Government departments must be able to seek formal assurances that income tax and National Insurance obligations are being met. Departments should terminate the contract if such assurances are not provided.
 - Any department found to be non-compliant with these new rules faced being ‘fined’ up to five times the cost of the salary by the Treasury.
187. These rules were formalised in Procurement Policy Note (PPN) 07/12, published by the Cabinet Office in August 2012. The PPN sets out illustrative contract clauses which allow assurances about tax arrangements to be sought; these were to be inserted into all new contracts (and contract renewals) from August 2012. The PPN also sets out a process, with guidance, for seeking assurances on tax and National Insurance from contractors. The scope of the PPN is outlined as “all central Government departments, including their executive agencies and Non Departmental Public Bodies”.

¹⁷⁹ The review considered ‘off-payroll’ arrangements as a whole and was not, therefore, limited solely to personal service companies HC Deb 2 February 2012 cc 1001–2.

¹⁸⁰ HC Deb, 23 May 2012 cols 1159–60.

¹⁸¹ *Ibid.*

188. In considering the use of personal service companies in the public sector, we were keen to understand the extent to which the Treasury Review had provided a comprehensive understanding of personal service company use across the sector, and the extent to which the Treasury Guidance, and PPN 07/12, had been implemented and taken effect. We began, however, by considering the broader principle of public sector use of personal service companies.

The principle of public sector use of personal service companies

189. Our Call for Evidence asked the following question:

“To what extent are personal service companies still used in the public sector? Should those engaged in public bodies and similar organisations be prevented from working through a personal service company? If so, would the public sector experience difficulties in obtaining the skills and expertise that are needed?”

190. We were told that public sector use of personal service companies typically fell into three categories. These were for interim management appointments, for time-limited project roles (particularly for IT infrastructure development projects) and for roles that had temporary or time-limited grant funding.¹⁸² HMRC told us that they currently had eight workers engaged through personal service companies; all eight were occupational psychologists.¹⁸³

191. We consistently heard that any blanket restriction on public sector use of personal service companies would be unhelpful. The REC suggested that the public sector might require highly skilled, flexible labour to carry out project work in much the same way that many private sector businesses require additional skills and capabilities from time-to-time. The IMA suggested that personal service companies are widely used for flexible deployment of people within the public sector, and that restrictions on their use would lead to escalating labour and recruitment costs.

192. This view was echoed by the PCG:

“The use of ‘personal service companies’ within the public sector is vital to the successful and efficient delivery of public services ... Freelancers provide a way for the public sector to engage specialists with experience outside the public sector on a short term basis, without the associated costs of full employment. Any blanket restriction on the ability of public sector bodies to acquire the services required in the most cost-effective manner risks being clearly detrimental to the value-for-money delivery of public services to the taxpayer, if the impact of the commercial strait-jacket effectively imposed is disproportional to the impact on tax”.¹⁸⁴

193. We were told that personal service companies in the public sector were largely used to meet the same needs as those met by personal service companies in the private sector; as such, it was considered that the public sector would be disadvantaged by any ‘tougher’ rules on their use. The BBC told us that:

¹⁸² QQ 63–65, evidence from LGA and DoH.

¹⁸³ Q 8

¹⁸⁴ PCG

“The growth of the flexible workforce in the UK cuts across all work requirements, from large creative IT projects to project management of infrastructure requirements. These are as applicable in the public sector as well as the private sector and there is no reason to create different ‘legislation’, either disadvantaging or creating an advantageous environment for either sector. The legislative framework should be applied consistently, irrespective of the funding of the engager”.¹⁸⁵

194. This view was echoed by the ICAEW and the Giant Group, amongst others. The IIM expressed a similar view, but noted that Government departments need to understand when off-payroll appointments are appropriate, and when they are inappropriate.
195. **We acknowledge that there will be circumstances in which public sector organisations, just like private sector organisations, may need to acquire services from those who operate through personal service companies. For this reason, we believe that any blanket restriction on public sector use of personal service companies would not be beneficial to the delivery of public services.**

The limitations of the Treasury Review

196. We were told that the Treasury Review had identified some cases of personal service company use within the public sector where IR35 should historically have been applied but had not been. Bauer & Cottrell told us that:

“The assurance exercise brought to light many cases that were very clearly inside IR35 but the individuals had been declaring an outside IR35 position. Some of these engagements had been going on for many years ... Many knew that they should have been treating themselves as IR35”.¹⁸⁶

These views were echoed elsewhere. The IIM told us that the review had “revealed that some engagements of personal service companies in the public sector had been in place for 10 years” and that this “appears to represent a failure on the part of Government departments to understand in what circumstances the use of off-payroll staff is appropriate and, more importantly, when staff should be on the payroll”.¹⁸⁷

197. We also heard that the process of, and publicity around, the review had helped to raise awareness of the issue of off-payroll engagements, even in those parts of the public sector not directly affected by the review. Michael Coughlin, of the Local Government Association (LGA), told us that, whilst local councils were excluded from the review, the LGA and other partners had sought to promote the resulting guidance to local authorities. Mr Coughlin stated that: “although it does not directly apply to the local government sector it has had an impact by default in the way it has been promoted and distributed through councils across the country”.¹⁸⁸

¹⁸⁵ BBC

¹⁸⁶ Bauer & Cottrell

¹⁸⁷ IIM

¹⁸⁸ Q 68

198. This evidence suggests that the Treasury Review has helped to encourage some greater degree of awareness within the public sector about good practice when engaging personnel off-payroll.
199. We do not, however, believe that the Treasury Review provided a comprehensive assessment of public sector use of personal service companies. The Review considered only central government and its arm's length bodies and did not directly include local government, parts of the National Health Service (NHS) and other parts of the public sector. This was identified as a limitation by a number of respondents to the Committee's Call for Evidence; a similar conclusion was made by the House of Commons Public Accounts Committee in September 2012.¹⁸⁹
200. In addition, the Treasury Review only considered workers who were engaged on a rate of £220 per day or more (approximately £58,200 per annum, potentially). This compares with median gross annual earnings in the UK which are currently around £27,000.¹⁹⁰
201. We sought evidence on the extent of personal service company use in local government. Whilst local government was excluded from the scope of the review, the LGA had sought to promulgate the guidance to its 351 member authorities, and had sought voluntary information on personal service company use in the sector. This information suggested that between 5 and 10% of local authorities were engaging people through personal service companies and that, in each of these, between one and five individuals were engaged in this way. These were typically interim management appointments, IT specialists or short-term project specialists. These figures applied only to those earning more than £50,000 per annum.¹⁹¹
202. The figures provided by the LGA were estimates, and covered by a number of caveats. It was clear to the Committee that, whilst the LGA had sought to take a responsible approach in promoting the Review and subsequent guidance to the local authority sector, no comprehensive figures for personal service company usage in local government are available. This reflects the fact that local government is not subject to the same degree of central control as central government and that the LGA is a body which serves its local authority members but does not direct them.
203. We also considered the use of personal service companies in the NHS. We were told that, whilst the required scope of the Treasury Review was to consider all workers engaged on £220 per day or more, the Department of Health (DoH), in implementing the review, had restricted the survey to staff at Board level only. This was "because of the very large numbers of NHS organisations and staff".¹⁹²
204. This survey—conducted in early 2012 and limited to Board-level staff in NHS Trusts, Foundation Trusts, Primary Care Trusts and Strategic Health Authorities—found that fewer than 2% of such appointees were engaged off-payroll. Specific figures for personal service company usage were not available, though "it was apparent that a significant number of executive

¹⁸⁹ Committee of Public Accounts, *Off-payroll arrangements in the public sector*: (12th Report, Session 2012–13, HC 532).

¹⁹⁰ ONS, *Annual Survey of Hours and Earnings*, 2013 provisional results.

¹⁹¹ Q 63

¹⁹² DoH

directors were engaged through personal service companies, including up to eight Chief Executives”.¹⁹³

205. Whilst recognising the complexity of health service structures and providers, and the difficulty and potential cost of surveying all parts of the NHS, we believe that this work could have gone further. We do not believe that the Treasury Review has provided a comprehensive assessment of personal service company usage in the public provision of health services.
206. We received further evidence that ‘off-payroll’ arrangements were being used more widely in the public sector. The NASUWT told us that such arrangements had grown exponentially in recent years, particularly for the provision of supply teachers.¹⁹⁴ This reflects the changing nature of education providers in the state sector with more providers independent of local authority control and less use by local authorities of an employed pool of supply teachers. These teachers, whilst not employed by the schools or local authorities in which they worked, were usually employed by umbrella companies. Personal service companies did not appear to be used.
207. Bauer & Cottrell, however, told us that they regularly came across personal service companies engaged as social workers, within the NHS and in teaching, and that numerous roles within local authorities were filled with personal service company users.¹⁹⁵ It is likely that many individuals in these professions would earn below £58,200 and would, therefore, have been excluded from the Treasury Review. We sought details of the extent to which those at the lower end of the pay spectrum might be engaged using personal service companies, or other off-payroll arrangements. Neither the LGA or the DoH was able to provide such details; both suggested that individuals at this end of the income scale were more likely to be engaged via agencies, but did not provide information about the precise employment circumstances of these individuals.¹⁹⁶
208. It is clear, therefore, that the Treasury Review of off-payroll appointments had a number of limitations. The review excluded workers earning less than £220 per day. We consider this to be a significant shortcoming. The Review was also limited to Government departments and their Non-Departmental Public Bodies; major areas of public sector service provision sit outside this scope. These shortcomings have been highlighted in earlier reviews; in our work, we have seen little evidence that they have been addressed in the intervening period.
209. **The Treasury Review of off-payroll appointments provided only a limited assessment of the extent of such engagements; large areas of public service provision, such as local government and some health services, were not included in its scope.**
210. **We recommend that the Government carry out an assessment of the extent to which off-payroll engagements are used elsewhere in the public sector, including by those earning less than £58,200 per annum.** (Recommendation 15)

¹⁹³ *Ibid.*

¹⁹⁴ NASUWT

¹⁹⁵ Bauer & Cottrell

¹⁹⁶ QQ 63–65

211. Another public service provider exempted from the Treasury Review was the BBC. The BBC was subject to some earlier criticism resulting from the use of personal service companies to engage both on air talent and flexible workers; in 2012 the Corporation told the Public Accounts Committee that they had identified 25,000 off-payroll contracts, including 13,000 contracts for ‘talent’.¹⁹⁷
212. We were told that the BBC “used to have a practice of requiring members of its flexible workforce to engage via a personal service company in certain circumstances”, but had now agreed a new framework and employment status tests, with HMRC, that were applicable for the broadcasting industry.¹⁹⁸ As a result, this practice had been changed, and personal service companies were only used when the work undertaken would support self-employment status. We welcome the flexible approach demonstrated by HMRC in working with the BBC to develop specific employment status tests for this sector; the framework and tests developed with the BBC should be made more widely available.

Implementing the new guidance

213. The guidance set out in Procurement Policy Note 07/12 was introduced in August 2012. In a report on off-payroll appointments published in September 2012 the House of Commons Public Accounts Committee concluded that there was “insufficient clarity on how government will implement the Treasury Review’s recommendations” and that there “is a risk that Treasury guidance may be interpreted inconsistently across the public sector”.¹⁹⁹
214. We heard evidence which suggested that this prediction may have come to pass. We were told that application of the guidance had not been consistent across, or even within, departments. Bauer & Cottrell suggested that there was a “complete lack of consistency across Departments” and that “some followed the guidance to the letter, some had the default approach that all personal service companies are within IR35 and some did not undertake the exercise at all”.²⁰⁰
215. We received further evidence to support this view. The FCSA told us that they had experience of public sector organisations “completely misunderstanding” the requirements of the new guidance. They suggested that some public sector bodies thought that the Business Entity Tests could be used to definitively determine employment status; this experience was also shared by the PCG. The PCG were of the view that recent moves within the public sector to reduce the number of off-payroll appointees had led to “widespread confusion”.²⁰¹
216. The DoH set out some of the difficulties involved in implementing the guidance:
- “Some organisations found this guidance relatively complex and in some cases experienced difficulty obtaining advice from HMRC. HMRC

¹⁹⁷ Committee of Public Accounts, 12th Report of Session 2012–13, *Op. Cit.*

¹⁹⁸ BBC

¹⁹⁹ Committee of Public Accounts, 12th Report of Session 2012–13, *Op. Cit.*

²⁰⁰ Bauer & Cottrell

²⁰¹ FCSA and PCG

officials were not all well informed about the HMT review ... There is no doubt that many NHS organisations find the IR35 legislation complex and difficult to interpret and implement. We in the Department of Health also found difficulty obtaining help with this from HMT and HMRC”.²⁰²

217. The new guidance required all Government departments to put in place provisions that allowed them to seek formal assurances that anyone paid over £220 per day and employed off-payroll for more than six months is satisfying their income tax and NIC obligations in full. Gordon Fleck, from the DoH, told us that this “means that there is now much greater confidence that people employed off payroll in the NHS are in fact meeting their proper obligations for tax and national insurance”.²⁰³
218. We would question, however, the extent to which this is the case. Within the NHS alone, there is evidence of inconsistent application of, and adherence to, the guidance. In June 2013, at the request of HMT, the DoH undertook a further survey of the NHS to assess compliance with the earlier guidance. This identified 2,403 off-payroll engagements in the NHS—more than the total identified in the January 2012 exercise. It also identified 148 cases where assurance regarding tax and NICs had been requested but not received.²⁰⁴
219. The NHS Trust Development Authority wrote to NHS Trusts on 6 September 2013, asking Trust Chairs to remedy all cases of non-compliance with the Treasury guidance. The Committee received evidence to suggest that there has been some progress in the situation since September 2013.²⁰⁵
220. NHS Foundation Trusts, however, enjoy a greater degree of autonomy. The Secretary of State has the legal power to direct NHS Trusts, but cannot direct Foundation Trusts; the arms length body Monitor regulates Foundation Trusts. The June 2013 survey found that 65 Board members or senior staff with significant financial responsibility were engaged off-payroll in Foundation Trusts. This included two chief executives, one of whom was engaged through a personal service company. The survey also stated that there were 99 cases, across 24 Foundation Trusts, where assurance regarding tax and NIC obligations had not been received.²⁰⁶
221. In September 2013 Monitor was asked, by the Secretary of State for Health, to investigate this non-compliance with the guidance by Foundation Trusts. We received an update on this work in March 2014; this stated that the number of off-payroll Board members or senior staff with significant financial responsibility now stands at 41.²⁰⁷
222. It is apparent that, within the DoH, the guidance has not, thus far, enjoyed universal success in providing assurance that those engaged off-payroll are meeting their tax and NIC obligations. We were told that the DoH intends to work with HMT, the NHS Trust Development Authority and Monitor to

²⁰² DoH

²⁰³ Q 69

²⁰⁴ DoH

²⁰⁵ *Ibid.*

²⁰⁶ *Ibid.*

²⁰⁷ DoH, supplementary written evidence.

develop new guidance on off-payroll engagements and to clarify areas that have caused confusion or uncertainty.²⁰⁸

223. PPN 07/12 stated that HMT and Cabinet Office would carry out a monitoring process in April 2013, requesting information on the number of off-payroll engagements for those earning over £220 per day that have lasted longer than six months, and the extent to which assurances on tax obligations have been sought and obtained for these appointments. In addition, Departments were asked to include, within their 2012/13 annual report and accounts, details of the outcome of applying PPN 07/12 to existing contracts. A written statement, summarising monitoring activity, was published in March 2014.²⁰⁹
224. Whilst this monitoring activity is to be welcomed it is clear, from the evidence that we have received, that different Departments have taken different approaches to implementing the guidance, and that the guidance has not enjoyed universal application and success across Government.
225. Whilst recognising the complexity of the task, we are concerned that the implementation of PPN 07/12 appears to have been inconsistent, both across and within Departments. The guidance is already limited by its scope, which includes only higher levels of pay and limited parts of the public sector. Inconsistent application further limits its scope, and confusion around how it should be applied—both within Departments and within HMRC—runs the risk of undermining any future evaluation of the success of this initiative in encouraging tax compliance amongst off-payroll appointees in the public sector.
226. **As the guidance embodied in Procurement Policy Note 07/12 currently appears to be applied inconsistently across departments, we recommend that Her Majesty's Treasury take a leading role in ensuring consistency of application and that it should go to greater lengths to monitor the implementation of the Procurement Policy Note 07/12 guidance across Government departments.**
(Recommendation 16)

²⁰⁸ *Ibid.*

²⁰⁹ HL Deb, 11 March 2014, col WS175.

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

1. We recommend that Her Majesty's Revenue and Customs carry out and publish a detailed assessment of the current Exchequer protection figure and of the costs that taxpayers incur in dealing with IR35. This should enable a better assessment of whether the legislation is having the intended effect and is proportionate. (Recommendation 1, paragraph 73)
2. Serial contracting is a feature of the modern British workforce and is supported by both businesses and contractors. We heard that although IR35 is not a significant issue for businesses, it can arouse considerable hostility from contractors.
3. Moreover, we note that compliance with the rules can demand a great deal of time and effort on the part of contractors. We acknowledge that it can be difficult for individuals contracting through personal service companies to define their tax and National Insurance position quickly and accurately because of the contract-by-contract nature of IR35 and the need for a sound understanding of case law.
4. We believe that the abolition or suspension of the IR35 legislation as proposed by the Office of Tax Simplification, whilst attractive, would be unwise if the legislation has the Exchequer protection effect claimed for it by Her Majesty's Revenue and Customs.
5. The current structure and rates of income tax and National Insurance provide an incentive for taxpayers to arrange their financial affairs in order to minimise the amount of tax and National Insurance paid. This has led to complex legislation, such as IR35, to counter such arrangements.
6. Whilst we recognise the complexities in merging income tax and National Insurance and the effect that this may have on the contributory principle, we recommend that the Government re-examine the longer term case for combining taxes on income and National Insurance. (Recommendation 2, paragraph 89)
7. We acknowledge that businesses would generally resist being made responsible for IR35 assessment, finding the additional administrative pressure and liability as overly burdensome.
8. We recommend that Her Majesty's Revenue and Customs look again at whether they require complete and accurate responses to the "service company" questions on the personal tax return SA100 and the real time information employer year end declaration (formerly P35). (Recommendation 3, paragraph 98)
9. If Her Majesty's Revenue and Customs decide that they need the information from those questions, we recommend that their completion should be made compulsory, backed up by the potential for penalties to be charged for incorrect answers or non-completion. (Recommendation 4, paragraph 99)
10. If Her Majesty's Revenue and Customs retain the questions, we recommend that they revise the guidance notes accompanying the personal tax return SA100 and the real time information year end declaration by employers to make the relationship to IR35 clearer. (Recommendation 5, paragraph 100)

11. If Her Majesty's Revenue and Customs decide that they do not need the information gained from the questions, we recommend that the questions be removed from the tax returns and declarations. (Recommendation 6, paragraph 101)
12. Her Majesty's Revenue and Customs did not convince us that the resources currently allocated were sufficient to ensure compliance with the IR35 legislation.
13. We recommend that Her Majesty's Revenue and Customs articulate with greater clarity the costs they incur from IR35 compliance efforts and administration, and the relationship between those costs and the overall yield gained from the legislation. (Recommendation 7, paragraph 113)
14. We conclude that many individuals simply take a risk that Her Majesty's Revenue and Customs will not look into their employment status, an attitude that is fostered by the decreasing number of compliance investigations.
15. We recommend that the Contract Review Service be publicised to greater effect, that Her Majesty's Revenue and Customs investigate ways to encourage individuals to use the service and that they look into ways to bolster confidence in its independence and impartiality. (Recommendation 8, paragraph 123)
16. We accept that the guidance will never be able to give absolute certainty to taxpayers of their status in relation to IR35 but we agree that the current guidance is far from satisfactory.
17. We recommend that Her Majesty's Revenue and Customs undertake a full consultation on how the Business Entity Tests could work better to provide greater certainty for taxpayers. (Recommendation 9, paragraph 134)
18. We commend the motive behind establishing the IR35 Forum as an opportunity for wider stakeholder engagement.
19. We recommend that Her Majesty's Revenue and Customs go to greater lengths to demonstrate that they are receptive to the feedback that is provided through this group and that they review the breadth of membership. (Recommendation 10, paragraph 140)
20. We are concerned that, in some sectors, individuals who are providing their services through personal service companies or, more often, umbrella companies and agencies, have a limited awareness of how they have been engaged to provide their work and who it is that has engaged them. This may mean that the individuals are not aware that they have foregone at least some levels of employment protection and benefits to which they would be entitled if they were in conventional employment. We recognise the complexity of the subject matter, and of the case law underpinning some of the distinctions made, but believe that it ought to be possible to present these issues in a concise and understandable manner.
21. We recommend that the Government should develop and publish a short guide setting out the basic differences between employment and self-employment. The guidance should be published across multiple platforms, including both digital and paper, and should be made available to individuals working in all industries where intermediaries are prevalent. (Recommendation 11, paragraph 164)

22. We recommend that the Government includes within the remit of the Low Pay Commission a consideration of the use of personal service companies and umbrella companies by lower-paid workers, and the implications for pay, employment rights and statutory entitlements. (Recommendation 12, paragraph 172)
23. As it is clear from the evidence that abuse of the expenses dispensations operated by umbrella companies is taking place, we recommend that Her Majesty's Revenue and Customs ensure that enforcement action is taken to end these abuses and to ensure that expenses dispensations are managed correctly. (Recommendation 13, paragraph 181)
24. We also recommend that Her Majesty's Revenue and Customs should review its processes for granting and renewing expenses dispensations, in order to ensure that potentially high risk organisations are granted dispensations only when appropriate. (Recommendation 14, paragraph 182)
25. We acknowledge that there will be circumstances in which public sector organisations, just like private sector organisations, may need to acquire services from those who operate through personal service companies. For this reason, we believe that any blanket restriction on public sector use of personal service companies would not be beneficial to the delivery of public services.
26. The Treasury Review of off-payroll appointments provided only a limited assessment of the extent of such engagements; large areas of public service provision, such as local government and some health services, were not included in its scope.
27. We recommend that the Government carry out an assessment of the extent to which off-payroll engagements are used elsewhere in the public sector, including by those earning less than £58,200 per annum. (Recommendation 15, paragraph 210)
28. As the guidance embodied in Procurement Policy Note 07/12 currently appears to be applied inconsistently across departments, we recommend that Her Majesty's Treasury take a leading role in ensuring consistency of application and that it should go to greater lengths to monitor the implementation of the Procurement Policy Note 07/12 guidance across Government departments. (Recommendation 16, paragraph 226)

APPENDIX 1: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

Members

Baroness Bakewell of Hardington Mandeville
 Baroness Donaghy
 Lord Empey
 Lord Higgins
 Lord Hope of Craighead
 Lord Levene of Portsoken
 Baroness Morgan of Huyton
 Lord Myners
 Baroness Noakes (Chairman)
 Lord Palmer of Childs Hill
 Lord Stewartby
 Lord Woolmer of Leeds (resigned 12 January 2014)

Declarations of interest

Baroness Bakewell of Hardington Mandeville
No relevant interests declared

Baroness Donaghy
No relevant interests declared

Lord Empey
No relevant interests declared

Lord Higgins
No relevant interests declared

Lord Hope of Craighead
No relevant interests declared

Lord Levene of Portsoken
Chairman, General Dynamics UK Limited
Director, Haymarket Group Ltd (publishing)
Director, Eurotunnel SA
Vice Chairman, Starr International Co Inc
Director, China Construction Bank (Asia) Corporation Limited
Chairman, Tikehau Investments Ltd
Governor, City of London School
Chairman, Bevis Marks Synagogue Trust
Shareholdings in Barclays plc, Apple Computers, Colgate (personal care),
BP, British Gas, Shell Petroleum, Scottish & Southern Energy,
GlaxoSmithKline (pharmaceuticals), Tesco, Goldman Sachs (investment
banking), Total SA (petroleum, France), Televisa, Mexico (cable tv), Wal-
Mart Stores, Inc (consumer goods), Research in Motion (mobile phones),
Deutsche Bank and Suncorp (petroleum, Canada)

Baroness Morgan of Huyton
Non-executive Director, Carphone Warehouse
Mentor for Mentore Consulting LLP
Occasional media work as member of Newsnight political panel
Chairman, OFSTED

Member, Advisory Committee, Board of Virgin Group Holdings Ltd (holding company)

Adviser, Board of ARK (Absolute Return for Kids; charity)

Member of Council, King's College, University of London

Member of Development Board, Frontline

Chair, Future Leaders (head-teacher training; charity)

Member, Advisory Board of Centre for Human Rights, Institute of Education, University of London

Board Member, Teaching Leaders (middle school leaders' training)

Lord Myners

No relevant interests declared

Baroness Noakes (Chairman)

Director, Carpetright plc

Director, Severn Trent plc (water)

Director, Royal Bank of Scotland Group plc

Shareholdings in a wide range of listed companies as listed in the Register of Members' interests

Lord Palmer of Childs Hill

No relevant interests declared

Lord Stewartby

No relevant interests declared

Lord Woolmer of Leeds

No relevant interests declared

A full list of Members' interests can be found in the Register of Lords Interests:

<http://www.parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-lords-interests/>

Anita Monteith, Specialist Adviser

An employee of the Institute of Chartered Accountants in England and Wales.

APPENDIX 2: LIST OF WITNESSES

Evidence is published online at <http://www.parliament.uk/personal-service-companies> and available for inspection at the Parliamentary Archives (020 7219 5314).

Evidence received by the Committee is listed below in chronological order of oral evidence session and in alphabetical order. Those witnesses marked with * gave both oral evidence and written evidence. Those marked with ** gave oral evidence and did not submit any written evidence. All other witnesses submitted written evidence only.

Oral evidence in chronological order

*	QQ 1–12	Her Majesty's Revenue and Customs (HMRC)
*	QQ 13–21	Office of Tax Simplification (OTS)
**	QQ 22–32	Professor Judith Freedman
*		Bauer & Cottrell
*		Low Incomes Tax Reform Group (LITRG)
*	QQ 33–41	Institute of Chartered Accountants in England and Wales (ICAEW)
*		Association of Chartered Certified Accountants (ACCA)
**		Chartered Institute of Taxation (CIOT)
*	QQ 42–61	Professional Contractors Group (PCG)
*		Federation of Small Businesses (FSB)
*		Freelancer and Contractor Services Association (FCSA)
**		APSCo
**	QQ 62–73	Local Government Association (LGA)
*		Department of Health (DoH)
**		NHS
*	QQ 74–80	Oil and Gas UK
*		Amey plc
**	QQ 81–92	TaxAid
*		National Association of Schoolmasters Union of Women Teachers (NASUWT)
**		Union of Construction, Allied Trades and Technicians (UCATT)
*	QQ 93–104	Institute of Directors (IoD)
*		Confederation of British Industry (CBI)
**	QQ 105–114	Crossrail
**		GlaxoSmithKline (GSK)

- ** BT
- * QQ 115–128 Her Majesty’s Revenue and Customs (HMRC)

Alphabetical list of all witnesses

- Mark Agombar
- Association of Accounting Technicians (AAT)
- * Association of Chartered Certified Accountants (ACCA) (QQ 33–41)
- * Amey plc (QQ 74–80)
- ** APSCo (QQ 42–61)
- British Broadcasting Corporation (BBC)
- * Bauer & Cottrell (QQ 22–32)
- BCS, The Chartered Institute for IT
- Graham Boyd
- Box Ten Ltd
- ** BT (QQ 105–114)
- Care UK
- Chartered Institute of Payroll Professionals (CIPP)
- Clifford Chance LLP
- * Confederation of British Industry (CBI) (QQ 93–104)
- ** Chartered Institute of Taxation (CIOT) (QQ 33–41)
- Sue Christensen
- ContractorCalculator
- Sam Corcoran
- ** Crossrail
- * Department of Health (DoH) (QQ 62–73)
- Peter Disney
- * Federation of Small Businesses (FSB) (QQ 42–61)
- Four Seasons Health Care (FSHC)
- ** Professor Judith Freedman (QQ 22–32)
- * Freelancer and Contractor Services Association (FCSA) (QQ 42–61)
- Fujitsu
- G4S plc
- Julian Gall
- Giant Group plc
- ** GlaxoSmithKline (GSK) (QQ 105–114)
- * Her Majesty’s Revenue and Customs (HMRC) (QQ 1–12) and (QQ 115–128)

HSBC

Julius J H Hutson

- * Institute of Chartered Accountants in England and Wales (ICAEW) (QQ 33–41)
- Institute of Chartered Accountants of Scotland (ICAS)
- * Institute of Directors (IoD) (QQ 93–104)
- Institute of Interim Management (IIM)
- Interim Management Association (IMA)
- David Kirk
- ** Local Government Association (LGA) (QQ 62–73)
- * Low Incomes Tax Reform Group (LITRG) (QQ 22–32)
- * National Association of Schoolmasters Union of Women Teachers (NASUWT) (QQ 81–92)
- Network Rail
- ** NHS (QQ 62–73)
- * Office of Tax Simplification (OTS) (QQ 13–21)
- * Oil and Gas UK (QQ 74–80)
- * Professional Contractors Group (PCG) (QQ 42–61)
- Paul Phillips
- Professional Passport
- Recruitment and Employment Confederation (REC)
- ** TaxAid (QQ 81–92)
- ** Union of Construction, Allied Trades and Technicians (UCATT) (QQ 81–92)
- Angela Williams

APPENDIX 3: CALL FOR EVIDENCE

A Select Committee of the House of Lords, chaired by Baroness Noakes, is conducting an inquiry into the use of Personal Service Companies in the public and private sectors. The Committee seeks evidence from anyone with an interest.

Written evidence is sought by **Tuesday 31 December 2013**. Public hearings of oral evidence will be held from November 2013 to January 2014. The Committee aims to report to the House, with recommendations and conclusions, in March 2014. The report will receive a response from the Government, and may be debated in the House.

The Committee is undertaking a review of the use of Personal Service Companies. It intends to consider the implications for tax, National Insurance and wider issues both from the point of view of workers and their clients.

The Committee seeks evidence on any aspect of this topic, particularly on the following questions:

- (1) To what extent are Personal Service Companies being used for the provision of personal services to UK businesses?
- (2) What is your view of the effectiveness and efficiency of the intermediaries legislation, first introduced in 2000, in facilitating tax collection?
- (3) Should the current intermediaries legislation be reformed and if so, what would be the alternatives?
- (4) To what extent does the current IR35 legislation impose additional compliance burdens and administrative costs?
- (5) Are the current avenues of consultation on IR35 working and what more should be done to ensure that the Government listens to interested stakeholders?
- (6) Are HMRC's recent efforts in improving the administration of IR35 judgement cases working? Is more guidance and advice needed to aid individuals in judging the status of business transactions for themselves or should further resources be given to HMRC for compliance efforts?
- (7) Do businesses insist on the use of Personal Service Companies? If so, should responsibility be placed on them rather than the worker to decide whether a business transaction falls within IR35?
- (8) Are individuals forced into the use of a Personal Service Company as a prerequisite for being considered for work? If so, what can be done to ensure that the use of a Personal Service Company is appropriate for the individual?
- (9) To what extent are Personal Service Companies still used in the Public Sector? Should those engaged in public bodies and similar organisations be prevented from working through a Personal Service Company? If so, would the Public Sector experience difficulties in obtaining the skills and expertise that are needed?
- (10) What role do Umbrella companies play? To what extent are agencies encouraging individuals to enter into such structures?

- (11) Aside from the issues of Tax and National Insurance, what are the wider benefits and drawbacks for the individual of using a Personal Service Company?

You need not address all these questions.

APPENDIX 4: GLOSSARY

AAT	Association of Accounting Technicians
ACCA	Association of Chartered Certified Accountants
BBC	British Broadcasting Corporation
BCS	Chartered Institute for IT (British Computing Society)
BETs	Business Entity Tests. A series of twelve tests, published by HMRC in May 2012, which seek to give contractors an indicator of the risk that IR35 would apply to a specific contract.
CIPP	Chartered Institute of Payroll Professionals
CIOT	Chartered Institute of Taxation
CIS	Constriction Industry Scheme
Compliance yield	The revenue collected by HMRC from enforcement action which uncovers non-compliance with the IR35 provisions.
CBI	Confederation of British Industry
DoH	Department of Health
Exchequer protection	The estimated amount of revenue which is 'protected' by the IR35 provisions (see paragraph 71)
Exchequer yield	The revenue collected by HMRC from taxpayers making payments in accordance with the IR35 provisions.
FSB	Federation of Small Businesses
Freelancer	An individual who, instead of working as an employee, offers their services as a limited-term contractor, sometimes working through a personal service company.
FCSA	Freelancer and Contractor Services Association
GSK	GlaxoSmithKline plc
HMRC	Her Majesty's Revenue and Customs
HMT	Her Majesty's Treasury
ICAEW	Institute of Chartered Accountants in England and Wales
ICAS	The Institute of Chartered Accountants of Scotland
IoD	Institute of Directors
IIM	Institute of Interim Management
IMA	Interim Management Association
Interim Manager	Interim managers are used to fill short-term management vacancies in both the public and private sectors.
IR35 Forum	Established in 2011, the Forum includes taxpayer representatives and professional advisers, providing advice to HMRC on the administration of IR35.

IR35 'rules' or IR35 legislation	The legislative provisions which seek to apply standard rates of income tax and National Insurance to personal service company engagements where, without the presence of the personal service company, the relationship would be considered one of employment. Named after the Inland Revenue press release number 35, which announced the initial introduction of these measures.
LGA	Local Government Association
LITRG	Low Incomes Tax Reform Group
LLP	Limited Liability Partnership
LPC	Low Pay Commission
MSC	Managed service company. Sometimes referred to as a 'composite', this company structure places contractors into groups of shareholders in a corporation, offering some of the benefits of operating through a limited company whilst limiting the administrative burden that would be experienced by a personal service company. The use of managed service companies was limited by legislation in 2007.
NASUWT	National Association of Schoolmasters Union of Women Teachers
NHS	National Health Service
NICs	National Insurance Contributions
ONS	Office for National Statistics
OTS	Office of Tax Simplification
PSC	Personal service company
PPN 07/12	Procurement Policy Note 07/12. Guidance, issued by the Cabinet Office, concerning off-payroll appointments in Government departments, their executive agencies and non-departmental public bodies.
PCG	Professional Contractors Group
REC	Recruitment and Employment Confederation
RTI	Real time information
Serial contracting	The practice of securing ongoing 'employment' by moving sequentially from one limited term contract to the next.
Umbrella company	An umbrella company provides invoicing, payroll and contract administration for flexible workers and contractors. The individuals concerned are employees of the umbrella company, and do not operate their own personal service companies.
UCATT	Union of Construction, Allied Trades and Technicians

APPENDIX 5: IR35

The Chancellor announced today that changes are to be introduced to counter avoidance in the area of personal service provision. This move underlines the Government's commitment to achieving a tax system under which everyone pays their fair share.

There has for some time been general concern about the hiring of individuals through their own service companies so that they can exploit the fiscal advantages offered by a corporate structure. It is possible for someone to leave work as an employee on a Friday, only to return the following Monday to do exactly the same job as an indirectly engaged 'consultant' paying substantially reduced tax and national insurance.

The Government is going to bring forward legislation to tackle this sort of avoidance. The Inland Revenue will be discussing the practical application of new legislation with interested parties and will work with representative bodies on the production of guidance. The new rules will take effect from April 2000.

Details

The Government is committed to encouraging modern businesses which develop and build on the strengths and commitment of their workforce. The aim of the proposed changes is to ensure that people working in what is, in effect, disguised employment will, in practice, pay the same tax and National Insurance as someone employed directly.

Businesses employing their workers directly say that they are unable to compete with those encouraging the avoidance at which the new legislation is aimed. As a result, ordinary workers can find they are unable to compete for jobs with those willing to participate in such arrangements. But those who do participate often have to pay a price in terms of loss of protection under employment law. They may find their terms and conditions altered—perhaps losing entitlement to sick pay or maternity leave. They may even lose their jobs without entitlement to notice or redundancy pay. They will usually have no right to any claim for unfair dismissal and may lose their entitlement to social security benefits through a failure to make adequate contributions.

The proposed changes are aimed only at engagements with essential characteristics of employment. They should affect only those cases where these characteristics are disguised through use of an intermediary—such as a service company or partnership. There is no intention to redefine the existing boundary between employment and self-employment.

Legislation is to be introduced to address the problem with effect from April 2000. However, a primary concern is to minimise any impact of these changes on ordinary businesses not involved in avoidance. To this end, the Inland Revenue will over the next few months be working with representative bodies on aspects of the practical application of the new rules and on the production of guidance.

HMRC

9 March, 1999