



HOUSE OF LORDS

Economic Affairs Committee
Finance Bill Sub-Committee

1st Report of Session 2019–20

Off-payroll working: treating people fairly

Ordered to be printed 22 April 2020 and published 27 April 2020

Published by the Authority of the House of Lords

Select Committee on Economic Affairs Finance Bill Sub-Committee

The Economic Affairs Finance Bill Sub-Committee was appointed by the House of Lords in this session “to consider the draft Finance Bill 2019.”

Membership

The Members of the Select Committee on Economic Affairs are:

[Baroness Bowles of Berkhamsted](#)

[Lord Burns](#)

[Viscount Chandos](#)

[Lord Cunningham of Felling](#)

[Lord Forsyth of Drumlean](#) (Chair)

[Lord Fox](#)

[Baroness Harding of Winscombe](#)

[Baroness Kingsmill](#)

[Lord Livingston of Parkhead](#)

[Lord Monks](#)

[Lord Skidelsky](#)

[Lord Stern of Brentford](#)

[Lord Tugendhat](#)

The Members of the Select Committee on Economic Affairs Finance Bill Sub-Committee are:

[Baroness Bowles of Berkhamsted](#)

[Lord Bridges of Headley](#)

[Lord Desai](#)

[Lord Forsyth of Drumlean](#) (Chair)

[Baroness Kramer](#)

[Lord Monks](#)

[Lord Rowe-Beddoe](#)

[Lord Tyrie](#)

Declarations of interests

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>

Publications

All publications of the Committee are available at:

<https://committees.parliament.uk/committee/175/economic-affairs-committee/>

All publications of the Sub-Committee are available at:

<https://committees.parliament.uk/committee/230/finance-bill-subcommittee/>

Parliament Live

Live coverage of debates and public sessions of the Committee’s meetings are available at:

<http://www.parliamentlive.tv>

Further information

Further information about the House of Lords and its committees, including guidance to witnesses, details of current inquiries and forthcoming meetings is available at:

<http://www.parliament.uk/business/lords>

Committee staff

The current staff of the committee are Tristan Stubbs (Clerk), Adrian Hitchins (Clerk), Mark Hudson (Policy Analyst), William Harvey (Policy Analyst), Claire Coast-Smith (Committee Assistant) and Mithula Parayoganathan (Committee Assistant). Robina Dyall and Sarah Squires are the specialist advisers to the Committee.

Contact details

All correspondence should be addressed to the Economic Affairs Committee, House of Lords, London SW1A 0PW. Telephone 020 7219 5358. Email financebill@parliament.uk

CONTENTS

	<i>Page</i>
Summary	2
Chapter 1: Introduction	5
Background	5
Chapter 2: Background to Finance Bill proposals	7
Changing patterns of employment	7
The history of IR35, 1999–2015	8
The Taylor Review of modern working practices	12
Chapter 3: Off-payroll rules in the public sector	16
Chapter 4: Extension of off-payroll rules to the private sector	20
Consultation on the extension of off-payroll rules to the private sector	20
Problems with the basic IR35 test	20
The Check Employment Status for Tax tool (CEST)	21
Potential cost to business of the new rules	24
Business readiness	25
Possible behavioural effects of the new rules	25
Umbrella companies	26
Possible labour market impacts	28
Policy objectives of the proposed changes	30
Compliance with existing legislation	30
Protecting the tax base	32
Fairness	32
Review of implementation	34
Deferral of the off-payroll working rules to 2021	35
Chapter 5: Alternatives to the off-payroll working rules	37
The Government's view of alternative approaches	37
Alternatives proposed by witnesses	38
A flat-rate withholding tax	38
Freelancer limited company (FLC)	38
A levy on using contractors, or 'engagers' tax'	39
Addressing the difference in NIC rates for the employed and self-employed	39
A statutory employment test	40
Office of Tax Simplification	41
Chapter 6: Guiding principles	44
Summary of Conclusions and recommendations	45
Appendix 1: List of Members and declarations of interest	50
Appendix 2: List of witnesses	52
Appendix 3: Call for evidence	57
Appendix 4: Summary of written evidence	59

Evidence is published online at <https://committees.parliament.uk/committee/230/finance-bill-subcommittee/publications/> and available for inspection at the Parliamentary Archives (020 7219 3074).

Q in footnotes refers to a question in oral evidence.

SUMMARY

It is right that everyone should pay their fair share of tax. But the evidence that we heard over the course of our inquiry suggests that the IR35 rules—the Government’s framework to tackle tax avoidance by those in ‘disguised employment’—have never worked satisfactorily, throughout the whole of their 20-year history. We therefore conclude that this framework is flawed.

Until the beginning of the COVID-19 pandemic, the Government had planned to extend off-payroll working rules to the private sector in April 2020. The off-payroll working rules build on IR35, and the new proposals were designed to mirror similar rules implemented in the public sector in 2017. Under the new rules IR35 itself will not change. Instead, large- and medium-sized businesses will be responsible for enforcing a regime which HMRC has struggled with.

The Government’s aim was to legislate for the new private sector rules in this year’s Finance Bill. But following the COVID-19 outbreak, and the Government’s assessment that introducing new rules was inappropriate at an extremely difficult time for the economy, the implementation of the rules will be deferred for a year.

We welcome this delay. It is right not to impose unnecessary burdens on business at such a difficult time. However, given the dysfunctionality of the existing system, we call on the Government to use the extra time to rethink fundamentally its approach to the legislation. We understand why, in order to improve compliance and protect the tax base, transferring responsibility for operating the rules to clients was deemed a remedy for the problems which have beset IR35. But the Government made this decision after considering the issue too narrowly, in terms of its tax take. It has severely underestimated the costs to business of implementing the changes. It did not take full account of concerns raised by stakeholders. And it did not analyse sufficiently the unintended behavioural consequences of the proposed reforms or their wider potential impact on the labour market, and on the gig economy in particular.

It is likely that the off-payroll changes will cause widespread disruption. Many of our witnesses described how the proposals had already encouraged blanket status determinations and the early termination of contracts. We also heard that many contractors had been left in an undesirable ‘halfway house’: they do not enjoy the rights that come with employment, yet they are considered employees for tax purposes. In short, they are “zero-rights employees”. Separating employment status for tax purposes from employment status under employment law also fails to acknowledge that contractors bear all the risk for providing the workforce flexibility from which both parties benefit.

The Government should therefore take the opportunity afforded by the delay to analyse holistically the problems that we have uncovered. If the Government continues with its plan to introduce the off-payroll reforms in April 2021, it should commission an independent review of the earlier introduction of the off-payroll rules in the public sector to analyse how introducing off-payroll rules to the private sector will affect the labour market. It should also, after two years of promising to do so, finally implement the recommendations of the Taylor Review of modern working practices: that the taxation of labour should be made more consistent across different forms of employment, while at the same time improving the rights and entitlements of self-employed people. We believe

that the Taylor Review proposals offer the best long-term alternative solution to the off-payroll rules, and provide an opportunity to consider tax, rights and risk together.

The UK economy is facing its most severe crisis since the Second World War. Even if the economy were to begin to recover in the next 12 months, the severity of the economic impact of COVID-19 is so great that it would be completely wrong for the Government to impose a new burden on business in the form of the existing off-payroll proposals. However, business is likely to need considerably longer than a year to recover from the disruption caused by the COVID-19 pandemic. The Government should announce by October 2020 whether it will indeed implement the off-payroll rules in April 2021, or whether any on-going impact to the economy resulting from the COVID-19 pandemic will require their implementation to be delayed further. In the longer term the Government should reassess the flawed IR35 framework, and give serious consideration to the fairer alternatives to the off-payroll working rules which we lay out in this report.

Off-payroll working: treating people fairly

CHAPTER 1: INTRODUCTION

1. On 17 March 2020, in response to the economic effects of the COVID-19 pandemic, the Government announced that it was postponing the introduction of reforms to off-payroll working. These reforms would have made large- and medium-sized organisations in the private and third sectors responsible for determining the employment status of contractors for tax purposes and for ensuring that, where relevant, employment taxes were paid. The evidence that we heard suggested that these reforms would have placed a significant burden on affected organisations and individuals. In this report we consider the proposals and explain why the Government was correct to delay their introduction until 6 April 2021. We suggest that the Government should use this additional time to reconsider its proposals, paying greater heed to wider changes in working practices.

Background

2. The Finance Bill Sub-Committee is appointed by the Economic Affairs Committee to consider technical issues of tax administration, clarification and simplification arising from the draft Finance Bill. In recognition of the House of Commons' financial privileges, the Sub-Committee does not inquire into rates or incidence of tax.¹
3. This year the Sub-Committee focused on the provisions in the draft Finance Bill, published on 7 July 2019, according to which off-payroll working rules similar to those introduced for the public sector in the Finance Act 2017 would apply to parts of the private sector.
4. On 7 January 2020 the Financial Secretary to the Treasury announced a review of the implementation of changes to the off-payroll rules in the private sector. The Government published its response to that review on 27 February 2020. In that response, the Government confirmed that these new off-payroll working rules would come into effect on 6 April 2020. However, on 17 March 2020 the Government announced that these off-payroll working rules would be deferred until 6 April 2021 as a result of the COVID-19 pandemic. On 26 March 2020, when announcing financial support to the self-employed in response to the pandemic, the Chancellor of the Exchequer said that people with different employment statuses may need to pay National Insurance Contributions (NICs) equally in the future if they are to “benefit equally from state support”.²
5. A large amount of the written evidence that we received came from individual contractors and their representatives, including the StopIR35 campaign group (which held a demonstration against the changes outside Parliament in February 2020). In total, we received more than 700 submissions, which

1 UK Parliament, ‘Financial privilege’, <https://www.parliament.uk/site-information/glossary/financial-privilege/> [accessed 16 April 2020]

2 Chancellor of the Exchequer, speech, ‘Chancellor outlines new coronavirus support measures for the self-employed’ (26 March 2020): <https://www.gov.uk/government/speeches/chancellor-outlines-new-coronavirus-support-measures-for-the-self-employed> [accessed 16 April 2020]

we summarise in Appendix 4. Such a response demonstrates the strength of feeling among those expected to be most affected by the changes. We thank everyone who provided written and oral evidence.

6. We regret that the COVID-19 pandemic meant that we were unable to hold a scheduled oral evidence session with the Financial Secretary to the Treasury, Rt Hon Jesse Norman MP. We are grateful to him for agreeing to appear before the Sub-Committee, and for his response to our written questions in lieu of oral evidence.

CHAPTER 2: BACKGROUND TO FINANCE BILL PROPOSALS

Changing patterns of employment

7. The Government’s off-payroll proposals respond to major changes in the way that people work. HMRC told us that the new rules formed part of the action that the Government needs to take to protect the tax base in the light of “a very significant shift in the way our labour market is operating”.³ The past two decades have seen a large increase in the number of self-employed and owner-managed businesses.⁴
8. In its *Employment status report*⁵ the Office of Tax Simplification (OTS) noted the long-term structural shift towards self-employment and the growth in the use of personal service companies (PSCs) by the self-employed.⁶ Instead of working directly for a client, individuals set up PSCs effectively to sell their services to a client. The reasons behind the growth in personal service companies were also considered in a 2014 House of Lords report on PSCs, which noted that for some workers the use of a PSC was mandated by clients who wished to manage the risk of the contractor being seen as an employee.⁷ Given the various tax and non-tax benefits that PSCs offer workers and clients,⁸ it is unsurprising that the number of PSCs has been increasing. The growth in PSCs is, in some ways, also illustrative of wider changes in the UK’s flexible labour market. Part of its current flexibility derives from a growth in the number of self-employed workers (who in 2016 reached a “high” of 15% of the UK labour force).⁹
9. Some of our witnesses highlighted the role that the gig economy played in increasing levels of self-employment. Businesses value the flexibility that such a workforce brings, without the responsibilities that come with an employment relationship.¹⁰ We were told by Siobhan Endean of Unite that PSCs were common among lower-paid workers (including those working in the gig economy).¹¹ The Employment Lawyers’ Association (ELA) described how self-employment was increasing in new sectors: “The growth of the gig economy has led to the use of off-payroll workers within business models and

3 [Q 54](#) (Cerys McDonald, HM Revenue and Customs)

4 [Q 54](#) (Cerys McDonald, HM Revenue and Customs). The May 2018 consultation document on the proposals said that this figure related only to companies with one or two directors. See HM Revenue and Customs, consultation document, Off-payroll working in the private sector (18 May 2018): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/708544/Off-payroll_working_in_the_private_sector_-_consultation_document.pdf [accessed 17 April 2020].

5 Office of Tax Simplification, *Employment status report* (March 2015): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/537432/OTS_Employment_Status_report_March_2016_u.pdf [accessed 16 March 2020]

6 Office of Tax Simplification, *Employment status report* (March 2015), Tables 1.D and 1.E summarise the drivers for self-employment from the perspective of worker and engager: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/537432/OTS_Employment_Status_report_March_2016_u.pdf [accessed 16 March 2020]

7 Select Committee on Personal Service Companies, *Personal Service Companies* (Report of Session 2013–14, HL Paper 160), chapter 2

8 The reasons for operating through a PSC were discussed by the House of Lords Select Committee on Personal Service Companies in chapter 2 of its report.

9 Matthew Taylor, *Good work: the Taylor Review of modern working practices* (July 2017): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf [accessed 16 April 2020], Chapter 4: Evolution of the labour market. In comparison, in 1975, the figure was 8.7%.

10 [QQ 42](#), [43](#) and [45](#) (Siobhan Endean, Unite) and written evidence from the Institute of Employment Rights ([DFD0140](#))

11 [Q42](#) (Siobhan Endean, Unite)

industries that have not traditionally engaged the self-employed.”¹² This was not wholly a positive experience for workers. The ELA continued: “In general, this ‘new wave’ of off-payroll workers tend to be less well remunerated than traditionally was the case for self-employed contractors engaged in skilled and specialist roles.”¹³

10. Other witnesses contrasted gig economy workers with contractors who fulfil more skilled and specialised roles, for whom self-employment is likely to be a positive choice. They outlined the different factors influencing contractors to choose self-employment.¹⁴ Professor Patricia Leighton of the Centre for Research on Self-Employment told us: “A very high percentage of the self-employed are self-employed because they reject the idea of being an employee.”¹⁵
11. We heard that the flexibility brought by such contractors was particularly valuable in certain sectors. John McVay of the Producers Alliance for Cinema and Television (PACT) said:

“When you are working in the creative industries, you have no advance order book; you generally have a very low number of fixed employees, and you hire in contractors and self-employed freelancers to complete the work ... that is how we remain efficient and competitive.”¹⁶
12. Oil and Gas UK noted how contractors with PSCs were an “essential part” of the oil and gas industry “because so much of the development of the North Sea Basin is done on multi-million pound investment projects”, which often require specialist expertise for only limited periods.¹⁷ Other witnesses described the benefits of having access to contractors on specific projects, which meant that engagers could again access specialist skills on a short-term basis.¹⁸
13. **Our witnesses described how workers become self-employed for many different reasons. We agree with HMRC that the growth in the numbers of self-employed people and of PSCs is evidence of a significant shift in how the UK labour market operates.**
14. **The growth of the gig economy in recent years has increased self-employment, particularly for lower-paid workers. It is regrettable that in some cases this has come at the expense of employment protections for workers.**
15. **The tax system needs to adapt to these significant labour market changes. However, the challenges posed by these changes go well beyond the tax system. Trying to address them from a tax perspective alone is unlikely to deliver the optimal solution.**

The history of IR35, 1999–2015

16. The Government first introduced the predecessor to the off-payroll working rules (‘IR35’) in 2000. This was in response to concerns about an increase

12 Written evidence from the Employment Lawyers’ Association ([DFD0108](#))

13 Written evidence from the Employment Lawyers’ Association ([DFD0108](#))

14 Written evidence from StopIR35 campaign ([DFD0096](#))

15 [Q 43](#) (Professor Patricia Leighton)

16 [Q 19](#) (John McVay, Producers Alliance for Cinema and Television)

17 Written evidence from Oil & Gas UK ([DFD0105](#))

18 Written evidence from Cornwallis Elt ([DFD0112](#)) and the Hydrogen Group ([DFD0119](#))

in the number of individuals who were setting up PSCs. PSCs had tax advantages for both the individual whose services were being sold and the business that purchased them. Payment to the PSC was made without the deduction of income tax and NICs under Pay As You Earn (PAYE), and the business client did not have to account for employers' NICs (all of which would have applied if the individual had been employed directly). The individual could take income from the company in the form of salary or dividends, or a mixture of the two, to optimise the tax advantages.

17. The Inland Revenue press release, IR35¹⁹, which announced the Government's plans at Budget 1999, was couched in terms of countering tax avoidance. The rules were targeted at situations where, without a PSC, the nature of the relationship between the individual and the client would have been in substance one of employment. If that relationship could be seen as employment, income from the client was taxed as employment income.²⁰ For the Government, IR35 was about ensuring "fairness": it meant that a worker using a PSC would no longer be able to avoid paying their "fair share" of income tax and NIC when effectively doing the same job as an employee.²¹
18. This 'deemed employment' was, however, limited to tax: there was no other impact on the arrangement between the individual and client; in particular, the individual continued to have no employment rights. As the press release made clear, people participating in such arrangements

"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."²²
19. Under the original proposal, the business client was to decide on the contractor's status. This idea was dropped following consultation because many businesses raised concerns about the resulting administrative burden. Instead, the PSC was given responsibility for determining the status of the relationship between client and contractor.²³
20. Provision for IR35 was included in the Finance Act 2000, and took effect from April 2000. But IR35 appears to have had limited success in addressing the problem that it was designed to solve. PSCs had little incentive to operate the new rules and, in any event, it could be genuinely difficult to decide whether they applied in particular situations. HMRC found it challenging to

19 Inland Revenue, Countering tax avoidance in the provision of personal services, Budget Notice IR35 (March 1999): <https://webarchive.nationalarchives.gov.uk/19991009125918/http://www.hm-treasury.gov.uk:80/budget/1999/nrindex.html> [accessed 16 April 2020]

20 IR35 applies for tax purposes only. It has no impact on the individual's status for employment law purposes.

21 Inland Revenue, Press Release: *Personal services provided through intermediaries, preventing avoidance: preserving flexibility* on 23 September 1999: <https://webarchive.nationalarchives.gov.uk/20140206165106/http://www.hmrc.gov.uk/ir35/seprelease.htm> [accessed 14 March 2020]

22 Inland Revenue, Countering tax avoidance in the provision of personal services, Budget Notice IR35 (March 1999): <https://webarchive.nationalarchives.gov.uk/19991009125918/http://www.hm-treasury.gov.uk:80/budget/1999/nrindex.html> [accessed 14 April 2020]

23 Inland Revenue, Press Release: *Personal Services provided through intermediaries, preventing avoidance: preserving flexibility* on 23 September 1999: <https://webarchive.nationalarchives.gov.uk/20140206165106/http://www.hmrc.gov.uk/ir35/seprelease.htm> [accessed 14 March 2020]

enforce compliance with the rules as investigations into individual contractual arrangements were resource-intensive for a relatively small yield.²⁴

21. The use of PSCs continued to grow. In 1999, when IR35 was announced, HMRC estimated that there were around 90,000 PSCs in the UK; by 2014, that estimate had grown to 200,000.²⁵ There is, however, a lack of reliable data on the number of PSCs in the UK.²⁶ HMRC told us that it was not possible to ascertain from tax returns information the extent to which PSCs are used. For modelling purposes HMRC therefore employs “proxy indicators” to estimate the number of PSCs.²⁷ It is possible that the 2014 estimates—and indeed HMRC’s current estimates²⁸—may not reflect the true number of PSCs.
22. This growth in PSCs—and the potential impact on tax revenues—led to a number of reviews of the IR35 regime in the 20 years in which the rules have existed. We discuss the most significant of these below. In response, HMRC has taken various steps to try to improve how it administers the rules; but other than these efforts, IR35 has remained largely unchanged.
23. In 2010 the Office of Tax Simplification (OTS) was asked by the Government to look into the operation of the IR35 rules as part of its work on the taxation of small businesses.²⁹ In the foreword to its interim report, published in March 2011,³⁰ the OTS said: “Of all the topics we tackled [IR35] proved to be the thorniest.”
24. The report commented that there was a widespread view that business had largely managed to navigate around the rules, and noted the existence of a general perception among contractors that the risk of HMRC investigation was low. The OTS recommended that, in the long term, the Government should look to integrate income tax and NICs, effectively making IR35 obsolete.³¹ However its immediate recommendations were that either IR35

24 HM Revenue and Customs, Intermediaries Legislation (IR35): discussion document (17 July 2015): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/446242/Intermediaries_legislation_IR35-discussion_document.pdf [accessed 16 April 2020] and HM Revenue and Customs, and HM Treasury, Consultation outcome, off-payroll working in the private sector (18 May 2018): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/708544/Off-payroll_working_in_the_private_sector_-_consultation_document.pdf [accessed 6 April 2020]

25 See supplementary written evidence from HM Revenue and Customs taken by the the Select Committee on Personal Service Companies (Session 2013–14), [p 164](#)

26 The lack of reliable data on PSCs was underlined by the Office of Tax Simplification in its 2011 review of IR35, and the 2014 House of Lords inquiry into PSCs. See Office of Tax Simplification, Small business tax review (March 2011): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/199183/05_ots_small_business_interim_report.pdf [accessed 17 April 2020]; and Select Committee on Personal Service Companies, *Personal Service Companies* (Report of Session 2013–14, HL Paper 160).

27 See joint written evidence from HM Revenue and Customs and HM Treasury ([DFD0154](#)). HMRC said that the “proxy definition” was agreed with the Office for Budget Responsibility.

28 Office for Budget Responsibility, Economic and Fiscal Outlook (11 March 2020), A.33: https://cdn.obr.uk/EFO_March-2020_Accessible.pdf [accessed April 2020]

29 Office of Tax Simplification, ‘Small business tax review: terms of reference’ (28 February 2012): <https://www.gov.uk/government/publications/small-business-tax-review/small-business-tax-review-terms-of-reference> [accessed 16 April 2020]

30 Office of Tax Simplification, Small business tax review: interim report (March 2011): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/199183/05_ots_small_business_interim_report.pdf [accessed 16 April 2020]

31 Office of Tax Simplification, Small business tax review: interim report (March 2011) chapter 5.10: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/199183/05_ots_small_business_interim_report.pdf [accessed 16 April 2020]

be abolished or, if retained, that HMRC should improve its administration of the rules.

25. The OTS considered other possible improvements to IR35, but these were ultimately rejected. One rejected suggestion was to transfer responsibility for operating the rules to the client; the OTS argued that this approach would not deal with any of the uncertainties around status under IR35 and, in compliance terms, would be onerous for businesses and HMRC.³²
26. The Government's response was to announce that IR35 would be retained but that there would be a "fresh look at how HMRC administers IR35".³³ Specialist compliance teams were created within HMRC, a helpline was set up and guidance was published to assist taxpayers. An IR35 Forum was established with representatives of accountancy bodies, contractors and HMRC. In 2012 a series of (non-statutory) "business entity tests" were introduced by HMRC to help contractors assess their IR35 risk, but withdrawn in 2015 after criticism that they added more confusion than clarity.
27. The administration of IR35 was considered in session 2013–14 by the House of Lords Select Committee on Personal Service Companies. Its report found that IR35 was needed to protect the Exchequer, but recommended that the Government re-examine the longer term case for merging income tax and NICs.³⁴ The Committee concluded: "[HMRC] did not convince us that the resources currently allocated were sufficient to ensure compliance with the IR35 legislation."³⁵
28. Although IR35 was specifically excluded from the OTS review of issues around Employment Status in 2014,³⁶ its final report noted:

"The general verdict is that IR35 is not working and, with its focus on individual assignments, is unlikely ever to work practically. It is also widely seen as unenforceable by HMRC".³⁷
29. A change to the income tax treatment of dividends to help address the incentive for some people to set up a company and make payments as dividends rather than as wages simply to reduce their tax bill, announced in 2015, was helpful in promoting the policy objective that underlies IR35, by reducing the tax benefits of PSCs for contractors. By itself, however, it was not sufficient to

32 Office of Tax Simplification, Small business tax review: interim report (March 2011) Appendix C, Table C.5: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/199183/05_ots_small_business_interim_report.pdf [accessed 16 April 2020]

33 Office of Tax Simplification, Small business tax review: Government response to Office of Tax Simplification recommendations (9 May 2011): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/199184/06_ots_xstletter_small_business_tax_review_090511.pdf [accessed 16 April 2020]

34 Select Committee on Personal Service Companies, *Personal Service Companies* (Report of Session 2013–14, HL Paper 160), recommendation 2

35 Select Committee on Personal Service Companies, *Personal Service Companies* (Report of Session 2013–14, HL Paper 160), paragraph 112

36 Office of Tax Simplification, Employment status review: terms of reference (11 July 2014): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/336877/OTS_employment_status_review_terms_of_reference.pdf [accessed 16 April 2020]

37 Office of Tax Simplification, Employment status report (March 2015): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/537432/OTS_Employment_Status_report_March_2016_u.pdf [accessed 16 April 2020]

discourage the use of PSCs.³⁸ At around the same time, the Government launched the consultation on IR35 that is discussed in Chapter 3.

30. **Off-payroll rules build on a flawed system—IR35. They separate employment status for tax purposes from employment status under employment law. This distinction is unacceptable, not least because it fails to acknowledge that contractors bear all the risk for providing the workforce flexibility from which both parties benefit.**

The Taylor Review of modern working practices

31. While the Government sought a solution to the problems presented by IR35 in the context of the tax system, the wider implications of the changes in the labour market for working practices, employment rights and employers were also coming under scrutiny.
32. The Deane Report, an independent review of the growth in self-employment, was published in February 2016.³⁹ In October 2016, the Government commissioned another independent review.⁴⁰ Headed by Matthew Taylor, the chief executive of the Royal Society for the Encouragement of Arts, Manufactures and Commerce (RSA), this review considered the changes in employment practices which might be needed to keep pace with developments in the labour market, including whether definitions of employment status should be updated to reflect new forms of working.⁴¹
33. The review was published in July 2017.⁴² Describing employment status as “the gateway” to a worker obtaining employment rights, the review concluded that the current employment status test—which, as we describe below, bases its assessments on existing case law—failed to meet the needs of the modern labour market: “Without an encyclopaedic knowledge of case law, understanding how this might apply to your situation is almost impossible.”⁴³
34. The Taylor Review therefore recommended that the Government legislate for a new, clear test of employment status with three categories of worker: employed, self-employed and “dependent contractor”. The test that it recommended was also based on case law principles—but it suggested that the Government set out in statute the criteria relevant to someone being an employee, with guidance and an online tool to provide further help. The new “dependent contractor” category was designed to cater for workers who were not employees, but equally were not genuinely self-employed. The review said that such workers should have certain employment rights—but would not be

38 Its effect was to reduce the potential for saving tax (although not NICs) by having the PSC pay dividends to its owner, rather than a salary.

39 Julie Deane OBE: Self-employment review: an independent report (14 February 2016): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/529702/ind-16-2-self-employment-review.pdf [accessed 21 April 2020]

40 The Department for Business, Energy and Industrial Strategy, Press Release: *Taylor Review on modern employment practices launches* on 1 October 2016: <https://www.gov.uk/government/news/taylor-review-on-modern-employment-practices-launches> [accessed 16 April 2020]

41 HM Government, ‘Employment practices in the modern economy, review scope’: <https://www.gov.uk/government/groups/employment-practices-in-the-modern-economy> [accessed 16 April 2020]

42 Matthew Taylor, *Good Work: The Taylor Review of modern working practices* (July 2017): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf [accessed 16 April 2020]

43 Matthew Taylor, *Good Work: The Taylor Review of modern working practices* (July 2017) p 34: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf [accessed 16 April 2020]

employees.⁴⁴ It concluded that only the genuinely self-employed should be excluded from employment protections.

35. Although its terms of reference did not include tax, many contributors to the Taylor Review raised issues with employment status for tax purposes.⁴⁵ The review suggested that the Government should consider aligning employment status with tax status as part of any work to develop the new “dependent contractor” category, so that differences between employment law and the tax rules were “reduced to an absolute minimum”. Appreciating that such alignment would take time, the Taylor Review commented that, in the short term while such work was ongoing, “Government could ensure that where a tribunal determines that an individual is an ‘employee’ for tax purposes, that decision is also binding for employment law purposes.”⁴⁶
36. The Taylor Review included a chapter setting out how the UK tax system influenced how people chose to work.⁴⁷ It noted: “The effective tax rates of a self-employed person are significantly below that of those in employment”.⁴⁸ Commenting on the increase in the number of people providing services through their own company, the Review added that even where this was to access limited liability or for another commercial reason, “even larger” differences in tax and NICs arose.⁴⁹ It highlighted what these tax differences meant:

“The tax system creates incentives for both the individual and the company to move towards a self-employment model, whether or not it is the most appropriate for their circumstances.”⁵⁰

37. The Taylor Review suggested that over the long term, the UK’s tax system should develop “a more consistent level of taxation on different forms of labour”, particularly around NICs (something that was proposed by the OTS in 2011).⁵¹ It recognised that any measures leading to this aim would be neither easy nor uncontroversial. The Taylor Review nevertheless saw more consistent taxation as critical, and included this goal in the first of its recommended “seven steps towards fair and decent work”:

“Over the long term, in the interests of innovation, fair competition and sound public finances we need to make the taxation of labour more

44 Matthew Taylor, *Good Work: The Taylor Review of modern working practices* (July 2017) p 36: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf [accessed 16 April 2020]

45 For example, see [Q 5](#) (Anita Monteith, Institute of Chartered Accountants of England and Wales)

46 Matthew Taylor, *Good Work: The Taylor Review of modern working practices* (July 2017) p 38: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf [accessed 16 April 2020]

47 Matthew Taylor, *Good Work: The Taylor Review of modern working practices* (July 2017) chapter 9: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf [accessed 16 April 2020]

48 Matthew Taylor, *Good Work: The Taylor Review of modern working practices* (July 2017) p 68: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf [accessed 16 April 2020]

49 Matthew Taylor, *Good Work: The Taylor Review of modern working practices* (July 2017) chapter 9: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf

50 In this context, the Taylor Review supported the proposals to reform NICs for the self-employed which were included in the March Budget of 2017. The Government did not proceed with these proposals.

51 Office of Tax Simplification, *Small business tax review: interim report* (March 2011): https://assets.publishing.service.gov.uk/Government/uploads/system/uploads/attachment_data/file/199183/05_ots_small_business_interim_report.pdf [accessed 14 March 2020]

consistent across employment forms while at the same time improving the rights and entitlements of self-employed people.”⁵²

38. The Government published its initial response to the Taylor Review in February 2018.⁵³ It accepted most of the Review’s recommendations and committed to improving clarity and certainty on employment status.⁵⁴ It launched a consultation on employment status for employment law and tax purposes, and acknowledged the need to consider employment status holistically. The consultation sought feedback on whether a person who was deemed to be an employee for tax purposes should receive some employment rights and, if so, what level of rights would be appropriate.⁵⁵ The consultation closed on 1 June 2018.
39. In December 2018 the Government published an update on its response to the Taylor Review.⁵⁶ It said:
- “Following consultation, we agree with [the Taylor Review’s] conclusion, and we will legislate to improve the clarity of the employment status tests, reflecting the reality of modern working relationships.”
40. The Government added that it would develop detailed proposals on how the employment and tax frameworks could be aligned. At the time of the publication of this report, no such detailed proposals had been published. Although the Financial Secretary to the Treasury told us that the Government was committed to introducing an Employment Rights Bill in the current Parliament to “offer greater protection for workers”,⁵⁷ there is no indication that the Bill will enact the Taylor Review’s recommendations on employment status.⁵⁸
41. The consultation document on the extension of off-payroll working to the private sector was published in February 2018. HMRC made clear that employment rights issues were outside the scope of the off-payroll consultation. HMRC said:
- “The Government recognises that the interaction between the employment status tests for employment rights and tax is an important

52 Matthew Taylor, *Good Work: The Taylor Review of modern working practices* (July 2017) p 110: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf [accessed 16 April 2020]

53 HM Government, *Good Work: A response to the Taylor Review of modern working practices* (February 2018): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/679767/180206_BEIS_Good_Work_Report_Accessible_A4_.pdf [accessed 16 April 2020]

54 Recommendations about changes to NICs were not accepted and ruled out of scope of the Employment status consultation. See HM Government, Press Release: *Millions to benefit from enhanced rights as government responds to Taylor review of modern working practices* on 17 February 2018: <https://www.gov.uk/government/news/millions-to-benefit-from-enhanced-rights-as-government-responds-to-taylor-review-of-modern-working-practices> [accessed 16 April 2020]

55 Department for Business, Energy and Industrial Strategy, HM Treasury and HM Revenue and Customs, ‘Employment status consultation’, (February 2018): <https://www.gov.uk/government/consultations/employment-status> [accessed 16 April 2020]

56 Department for Business, Energy and Industrial Strategy, *Good Work Plan* (17 December 2018): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/766167/good-work-plan-command-paper.pdf [accessed 16 April 2020]

57 Written evidence from Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, HM Treasury (DFD0156)

58 Prime Minister’s Office, *Queen’s Speech December 2019: background briefing notes* (19 December 2019): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/853886/Queen_s_Speech_December_2019_-_background_briefing_notes.pdf [accessed 16 April 2020]

and complex issue, and so will work with stakeholders to ensure that any potential changes are considered carefully.”⁵⁹

42. A number of our witnesses were disappointed that the off-payroll rules were being introduced before any of the recommendations of the Taylor Review, emphasising the need for these issues to be considered holistically.⁶⁰ Meredith McCammond of the Low Income Tax Reform Group (LITRG) referred to “fault-lines” in the system between employment law and tax law, saying:
- “Those fault lines drive distortive behaviour, so that all that measures such as ... the off-payroll working rules do is put sticking plasters over them. A better way of dealing with all this would be to have a wholesale, comprehensive review of the system that underpins the labour market ... this is because sticking plasters do not work and what is actually required is a long-term, sustainable solution”.⁶¹
43. **We support IR35’s original policy aims of trying to ensure greater fairness in the tax system, and of preventing some contractors and client businesses gaining an unfair tax advantage. However, we are concerned that the rules have proved to be ineffective over a prolonged period and that, notwithstanding its reviews of IR35, the Government has not done more to tackle such problems, or to find a better alternative to these rules. Furthermore, with the emergence of the gig economy in the intervening years, the nature of employment has changed. This puts the issue of “fairness” in a new context.**
44. **There was significant support from our witnesses for the recommendations in the Taylor Review—and significant disappointment that work on them seems to have stalled.**
45. **It is concerning that the Government has pressed ahead with the off-payroll working rules at a time when the Taylor Review, which it commissioned, recommended a more holistic solution than these rules can offer. This is a solution with which the Government has said that it agrees, and on which it had launched a consultation. The lack of strategic co-ordination on this issue across Government and between Departments is highly regrettable.**
46. **We recommend that the Government carry forward its work on the Taylor Review, to develop the review’s ideas into legislation which is responsive to the changing labour market and works across both tax and employment law.**

59 HM Revenue and Customs, Off-payroll working in the private sector: consultation document (February 2018), section 2.13: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/822388/Consultation_document_off-payroll_working_rules_from_April_2020.pdf [accessed 16 April 2020]

60 For example, [Q 16](#) (Abigail Agopian, Confederation of British Industry), [Q 18](#) (Andrew Chamberlain, Association of Independent Professionals and the Self-Employed), [Q 33](#) (Keith Gordon) and written evidence from the Office of Tax Simplification ([DFD0104](#)), Association of Independent Professionals and the Self-Employed ([DFD0101](#)), the Employment Taxes Industry Forum ([DFD0121](#)), the Employment Lawyers’ Association ([DFD0108](#)), Mr Philip Beardwood ([collated written evidence from individuals](#)) and Mr Steven Harrison ([collated written evidence from individuals](#))

61 [Q 10](#) (Meredith McCammond, Low Incomes Tax Reform Group)

CHAPTER 3: OFF-PAYROLL RULES IN THE PUBLIC SECTOR

47. After several years of attempts by HMRC to improve the operation of IR35 administratively, the Government announced at Budget 2015 that it would look again at the IR35 rules themselves. It issued a discussion document which recognised that non-compliance with IR35 was widespread, and concluded that increasing HMRC's compliance response would not be enough.⁶² The document floated the idea of transferring responsibility for applying the rules from contractors to clients.
48. Responses to the document mentioned concerns about the likely cost and administrative burden to clients, the possible negative effect on the UK labour market and the risk of "over-compliance" by risk-averse clients.⁶³ Some respondents suggested that problems with HMRC's compliance activity be addressed. However, at the 2016 Budget the Government announced that it would proceed with the change to transfer responsibility for applying the rules to the client, but that this change would be confined to the public sector. The new rules were legislated for in the Finance Act 2017 and came into effect in April 2017.
49. This timetable was criticised for allowing the public sector insufficient time to prepare for the change and for giving the sector insufficient support.⁶⁴ TaxAssist Direct Ltd recalled in evidence to this inquiry that "engagers were wholly unprepared and under resourced."⁶⁵ The Association of Professional Staffing Companies Ltd wrote: "The rollout of the new off-payroll rules in the public sector has been disruptive throughout the whole supply chain."⁶⁶
50. HMRC commissioned a report from IFF Research and Frontier Economics (IFF) on how the implementation in the public sector had worked. The research was carried out in the summer and autumn of 2017. Some of our witnesses (for example, the Institute of Chartered Accountants of Scotland (ICAS)) felt that this research was conducted too early for the report to reflect accurately the public sector's experience of the new rules.⁶⁷ Stop the Off-payroll Tax also criticised the research for failing to involve key stakeholders such as contractors and agencies.
51. The IFF research report, which was published in May 2018, found that since the introduction of the new rules there had not been any significant change in the public sector's employment of contractors; nor had there been an impact on recruitment or on the public sector's ability to hire flexible labour.⁶⁸ However, Hays referred us to a survey carried out with Contractor Calculator at around the same time, which they said showed that "76% of

62 HM Revenue and Customs, Intermediaries Legislation (IR35): discussion document (17 July 2015): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/446242/Intermediaries_legislation_IR35-discussion_document.pdf [accessed 16 April 2020]

63 HM Revenue and Customs, Consultation Document, Off-payroll working in the public sector: reform of the intermediaries legislation (26 May 2016), pp 35–41: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/526614/Off-payroll_working_public_sector-reform_intermediaries_legislation.pdf [accessed 16 April 2020]

64 Written evidence from NHS Digital (DFD0115), Cornwallis Elt (DFD0112), Deloitte (DFD0120)

65 Written evidence from TaxAssist Direct Ltd (DFD0113)

66 Written evidence from the Association of Professional Staffing Companies Ltd (DFD0110)

67 Written evidence from Low Incomes Tax Reform Group (DFD0100)

68 HM Revenue and Customs, Off-Payroll Reform in the Public Sector (May 2018): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/704931/Off-Payroll_Reform_in_the_Public_Sector.pdf [accessed 6 April 2020]

departments had lost highly skilled contractors” and 71% of IT projects had seen delays—with some being scrapped.⁶⁹

52. Contrary to these findings, HMRC’s view is that implementation of the public sector off-payroll working rules was a success. HMRC emphasises the increase in the tax yield of £250 million in the first 12 months of the new rules, which was more than had been expected.⁷⁰
53. Our witnesses painted a less rosy picture. NHS Digital reported that it had considerable difficulty in applying the legislation: it now uses three different tests to determine whether a contractor is within or outside the rules.⁷¹ It told us that it had experienced increased overhead costs in terms of implementation and ongoing management—and that, three years on, it was still in discussions with HMRC about relevant tax liabilities.
54. We heard from other witnesses that parts of the public sector had reacted by making ‘blanket assessments’ that groups of contractors were within the rules—the conclusion that, they felt, was least likely to be challenged by HMRC.⁷² The Independent Health Professionals’ Association (IHPA) initiated legal action against NHS Improvement for advising NHS trusts to make blanket assessments, when the rules were clear that each case had to be considered on its own facts. IHPA was successful in getting the advice withdrawn, but submitted evidence suggesting that HMRC had subsequently encouraged the NHS to consider the status of contractors in groups rather than individually. It said that NHS Trusts began to advertise posts as “inside IR35” and that NHS Improvement instructed operators to insert clauses into their framework agreements which appeared to be aimed at bringing contracts within the off-payroll rules. IHPA told us: “We are not aware of a single NHS trust in the country which is not blanket-assessing healthcare workers inside the legislation.”⁷³
55. These reports suggest that some part of the yield from the new rules may have arisen from mis-categorisation of contractors as within the off-payroll rules, rather than from improved compliance. Julia Kermode of the Freelancer and Contractor Services Association (FCSA) said:

“HMRC has stated that the public sector reforms were successful and delivered an increase in compliance by virtue of the fact that more payroll taxes were taken. I argue that that does not demonstrate an increase in

69 Written evidence from Hays Recruitment Consultancies (DFD0136). In its written evidence, the Association of Independent Professionals and the Self-Employed (DFD0101) referred us to research they had carried out in conjunction with the Chartered Institute of Personnel and Development evidencing similar disruption in the public sector.

70 HM Revenue and Customs, Review of changes to the off-payroll rules: report and conclusions (27 February 2020): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/867519/20-02-19_-_FINAL_Off-payroll_Review_Document.pdf [accessed 16 April 2020]; and Office for Budget Responsibility, Economic and Fiscal Outlook (11 March 2020), A.33: https://cdn.obr.uk/EFO_March-2020_Accessible.pdf [accessed 16 April 2020]

71 Written evidence from NHS Digital (DFD0115) and Q 62 (Carl Vincent, NHS Digital)

72 For example, written evidence from the Institute of Chartered Accountants of Scotland (DFD0099), the Recruitment and Employment Confederation (DFD0123), Freelancer & Contractor Services Association (DFD0102), TaxAssist Direct Ltd (DFD0113), Morson (DFD0114), SThree Group PLC (DFD0116) Ms Jane Johnson (collated written evidence from individuals), Mr Amritpal Gill (collated written evidence from individuals) and Mr Andy Ong (collated written evidence from individuals).

73 Written evidence from the Independent Health Professionals’ Association (DFD0103)

- compliance; it demonstrates an increase in people being put on payroll, perhaps incorrectly.”⁷⁴
56. Another issue was how contractors reacted to the introduction of the public sector rules. IHPA told us that many healthcare contractors were working less or had simply left the health service. NHS Digital had found it “an additional challenge to recruit and retain the right resources”. Some of its contractors left; some were prepared to stay only if paid more; others accepted the lower level of take-home pay. Where NHS Digital wished to retain contractors who would otherwise leave, it found that it had to pay them about 25% more.⁷⁵
 57. The Association of Chartered Certified Accountants (ACCA) and the Law Society for Scotland (LSS) pointed to reports that IT contractors had left the public sector.⁷⁶ The Recruitment and Employment Confederation (REC) referred to a Transport for London investment programme report, which stated: “A significant number of critical ... project employees left TfL as a result of IR35.” Their departure resulted in delays to updates of Bakerloo line trains.⁷⁷
 58. Some contractors seem to have decided not to take any more work in the public sector, but to work exclusively in the private sector, where the rules did not apply.⁷⁸ A survey by the StopIR35 group in February 2020 indicated that 11% of those contractors surveyed had moved from the public to the private sector.⁷⁹ Another by SThree Group plc (SThree) suggested that 15.5% had left the public sector.
 59. A further consequence noted in evidence was that more contractors chose or felt obliged to work through an umbrella company.⁸⁰ A number of witnesses (for example, the LITRG) expressed concerns about this development; they felt that there was a potential for workers to find themselves in a non-compliant umbrella arrangement.⁸¹
 60. We have not, from the evidence received, been able to quantify the extent to which the rules have been applied correctly—or misapplied—in the public sector. Nor can we quantify the impact of the rules on contractor numbers. We note, however, that the difficulties that witnesses related to us are similar to the concerns expressed in response to the 2015 discussion document.

74 [Q 17](#) (Julia Kermode, Freelance and Contractor Services Association)

75 [Q 60](#) (Carl Vincent, NHS Digital)

76 Written evidence from the Association of Chartered Certified Accountants ([DFD0098](#)) and Law Society for Scotland ([DFD0107](#))

77 Written evidence from the Recruitment and Employment Confederation ([DFD0123](#)); Transport for London, Investment Programme Report (October 2017): <http://content.tfl.gov.uk/pic-20171013-agenda-item05-investment-programme-q1.pdf> [accessed 14 April 2020]

78 For example see written evidence from Mr Amritpal Gill ([collated written evidence from individuals](#)) and Mr Andy Ong ([collated written evidence from individuals](#)).

79 Written evidence from StopIR35 Campaign ([DFD0096](#)). There is no statutory definition of an ‘umbrella company’, although it is generally accepted that an umbrella company is a company that employs temporary workers who work at different end clients’ premises. Umbrella companies do not source work. Typically the umbrella will enter into a contract with a recruitment agency who will source work from end clients. See HM Revenue and Customs, ‘Employment Status Manual’ (7 March 2016): <https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm2390> [accessed 20 April 2020]

80 Written evidence from SThree Group plc ([DFD0116](#))

81 [Q 10](#) (Meredith McCammond, Low Incomes Tax Reform Group)

There was a general consensus among witnesses that not enough had been done to evaluate the effect of the public sector changes.⁸²

61. **In some parts of the public sector (including the NHS) the off-payroll working rules were not applied properly. As a result of blanket assessments, contractors are likely to have been miscategorised and taxed incorrectly. Some contractors ceased working in the public sector altogether, causing recruitment and retention problems.**
62. **It is regrettable that no proper evaluation has been carried out into the effect of the off-payroll working rules in the public sector. Such an evaluation should have preceded and informed any decision to extend the rules to the private sector.**
63. **We are not convinced that the Government has learnt lessons from the application of IR35 in the public sector. If the Government continues with its plan to introduce the off-payroll reforms in April 2021, we recommend that the Government undertake an independent review of the implementation of the off-payroll rules in the public sector and an analysis of the impact of those rules on the labour market.**

82 See for example written evidence from Law Society of Scotland ([DFD0107](#)) and Morson Group ([DFD0114](#))

CHAPTER 4: EXTENSION OF OFF-PAYROLL RULES TO THE PRIVATE SECTOR

Consultation on the extension of off-payroll rules to the private sector

64. At the autumn Budget in 2017, a few months after the public sector reforms came into effect, the Government announced plans to tackle non-compliance in the private sector. This was followed by a consultation in summer 2018 on the extension of the new public sector off-payroll rules to the private sector.⁸³ The vast majority of respondents expressed concerns that the extension of the rules would lead to an increased burden on businesses. Many suggested postponing implementation until the Government had decided on any changes to employment status (on which it had recently consulted), which would potentially replace the status test in the off-payroll rules.⁸⁴
65. At section 1.3 of its 2018 consultation document, the Government stated that it was “committed to learning from the experience of the public sector implementation”.⁸⁵ Our witnesses questioned whether the Government had indeed learned any lessons. In particular, we were told that the external IFF report on the public sector implementation did not amount to a proper evaluation of the rules. Instead, as we argued in chapter 3, the rules are being extended to the private sector with few amendments to reflect lessons learned.⁸⁶
66. The Government confirmed at the 2018 Budget that the off-payroll rules would be extended to the private sector from April 2020, with the smallest organisations excluded. Further consultation—on the detail of the legislation—followed in early 2019, with draft legislation published in July 2019. Following the Government’s decision to defer implementation to April 2021, no provision was included in the Finance Bill 2020 published on 19 March 2020, although amendments will be tabled to the Bill to include the provisions.

Problems with the basic IR35 test

67. As many witnesses pointed out, the new off-payroll working rules make no changes to the basic test for deemed employment under IR35. Instead, where the private sector client is a large or medium-sized business, they simply transfer from the contractor to their client the obligation to determine whether an individual contractor should be treated for tax and NIC purposes as an employee. If the client is a small business, IR35 continues to apply, as now, to the contractor. Most witnesses welcomed the exclusion of small businesses from the rules, although some felt otherwise (for example, according to the

83 HM Revenue and Customs, and HM Treasury, Consultation outcome, off-payroll working in the private sector (18 May 2018): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/708544/Off-payroll_working_in_the_private_sector_-_consultation_document.pdf [accessed 6 April 2020]

84 The Department for Business, Energy and Industrial Strategy, HM Treasury and HM Revenue and Customs, ‘Employment status consultation’, (February 2018): <https://www.gov.uk/government/consultations/employment-status> [accessed 16 April 2020]

85 HM Revenue and Customs, and HM Treasury, Consultation outcome, off-payroll working in the private sector (18 May 2018): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/708544/Off-payroll_working_in_the_private_sector_-_consultation_document.pdf [accessed 6 April 2020]

86 See, for example, written evidence from Association of Chartered Certified Accountants (DFD0098) Low Incomes Tax Reform Group (DFD0100), SThree Group PLC (DFD0116) and Deloitte (DFD0120)

Recruitment and Employment Federation (REC) this exclusion “complicates an already complicated tax reform”).⁸⁷

68. Many witnesses described difficulties in applying the IR35 test to determine employment. The test, based on case law, involves “technical legal concepts that many would never come across unless assessing employment status”, according to the Federation of Small Business.⁸⁸ Other witnesses reported that although in some instances it might be relatively easy to determine a person’s status, there were many cases where it was much harder: “Some people are very obviously self-employed, some are very obviously quasi-employed ... and then there is a group in the middle.”⁸⁹ Given that different people reach different answers when applying the test, Anita Monteith of the Institute of Chartered Accountants in England Wales (ICAEW) suggested: “this should tell us something is wrong”.⁹⁰
69. Several witnesses questioned whether HMRC had a full understanding of the test, given its success rate in IR35 challenges at tax tribunals. The OTS described HMRC’s record as “mixed”;⁹¹ the IHPA told us: “HMRC routinely gets it wrong as can be seen by how often they lose at tribunal.”⁹²

The Check Employment Status for Tax tool (CEST)

70. At the time of the public sector reforms, HMRC introduced an online tool—’Check Employment Status for Tax’—intended to help public sector bodies assess the status of contractors. CEST has been much criticised,⁹³ leading HMRC to make various changes. It launched an updated version in November 2019.⁹⁴
71. We heard a significant amount of criticism of CEST from many different witnesses (contractors, business organisations and representative bodies), and from NHS Digital about its experience of CEST during the last three years.⁹⁵ We were told that CEST provides an answer in around 85% of cases⁹⁶—although a recent freedom of information release by HMRC suggested that, since CEST was updated, this proportion had fallen to around 80%.⁹⁷ While

87 Written evidence from the Recruitment and Employment Confederation ([DFD0123](#))

88 Written evidence from the Federation of Small Businesses ([DFD0106](#))

89 [Q 33](#) (Stephen Ratcliffe, the Employment Lawyers’ Association). See also [Q 3](#) (Anita Monteith, Institute of Chartered Accountants of England and Wales) and [Q 26](#) (Bill Dodwell, Office of Tax Simplification).

90 [Q 6](#) (Anita Monteith, Institute of Chartered Accountants of England and Wales)

91 Written evidence from Office of Tax Simplification ([DFD0104](#))

92 Written evidence from Independent Health Professionals Association ([DFD0103](#))

93 For example see Chartered Institute of Taxation, Press Release: *Improvements urgently needed to HMRC’s IR35 assessment tool for off-payroll working rules to operate effectively* on 11 July 2019: <https://www.tax.org.uk/media-centre/press-releases/press-release-improvements-urgently-needed-hmrc%E2%80%99s-ir35-assessment-tool> [accessed 17 April 2020]

94 Certain documents relating to the November 2019 update of CEST were published by HM Revenue and Customs in response to a freedom of information request on 17 March 2020. See HM Revenue and Customs, ‘Check Employment Status for Tax (CEST): 2019 enhancement’, (17 March 2020): <https://www.gov.uk/government/publications/check-employment-status-for-tax-cest-2019-enhancement> [accessed 17 April 2020]

95 [QQ 58](#) and [59](#) (Carl Vincent, NHS Digital) and written evidence from NHS Digital ([DFD0115](#))

96 [Q 56](#) (Cerys McDonald, HM Revenue and Customs), and see also HM Revenue Customs, ‘Issue briefing: reform of off-payroll working rules’ (22 October 2019): <https://www.gov.uk/government/publications/hmrc-issue-briefing-reform-of-off-payroll-working-rules/hmrc-issue-briefing-reform-of-off-payroll-working-rules>

97 HM Revenue and Customs, ‘Check Employment Status for Tax (CEST): 2019 enhancement’, (17 March 2020): <https://www.gov.uk/government/publications/check-employment-status-for-tax-cest-2019-enhancement> [accessed 17 April 2020]

this means that the tool provides an answer in a large majority of cases, in “a substantial minority”, it provides no determination.⁹⁸ To put this in context, HMRC states that around 230,000 PSCs fall within the scope of the new rules, meaning that, based on 15%, up to 35,000 PSCs will be likely to have an “undetermined status” under CEST. Clients engaging those PSCs will therefore need additional assistance. As ICAS put it: “This is not a matter upon which people can self-educate.”⁹⁹ Clients would be able to use HMRC’s dedicated helpline for assistance, but ICAEW questioned whether this was a “satisfactory” solution.¹⁰⁰

72. Witnesses acknowledged that it was probably impossible to create a tool that would produce an answer in every case, given the complexity of the case law employment test¹⁰¹ and the wide variety of sectors and business models for which the tool needs to cater.¹⁰² At the same time, we were told how important certainty was to business and that, in this context, CEST’s no-response rate was unacceptably high.¹⁰³ Contractors were worried that “no response” could lead risk-averse businesses simply to declare a contractor within IR35—regardless of whether this was a correct assessment—resulting in false employment and additional tax to pay.¹⁰⁴
73. A key concern of many witnesses was that CEST did not, in their view, fully reflect the case law. The Financial Secretary to the Treasury wrote that CEST had been “rigorously tested against established case law and settled cases” to ensure that it gave accurate results.¹⁰⁵ HMRC told us that CEST would come to the same conclusion as a tax tribunal in cases that were not borderline.¹⁰⁶ However, Keith Gordon, a barrister at Temple Tax Chambers, described a recent case in which the judge had said that one of Mr Gordon’s clients was clearly self-employed (and not at all borderline)—but that when Mr Gordon put the facts into CEST, the tool said that the client was an employee.¹⁰⁷
74. One issue that frequently reappeared in our evidence was that CEST fails to deal with “mutuality of obligation”.¹⁰⁸ We were told that this was a key employment law concept,¹⁰⁹ which was “discussed every time” in tribunal cases.¹¹⁰ ICAS said that the omission of this test meant that the tool was “flawed”,¹¹¹ REC said that it damaged “the legitimacy of the tool”.¹¹² HMRC

98 Written evidence from the Employment Lawyers’ Association ([DFD0108](#)): we were told that judgments tended to be “extremely nuanced and fact-sensitive”.

99 Written evidence from Low Incomes Tax Reform Group ([DFD0100](#))

100 [Q 3](#) (Anita Monteith, Institute of Chartered Accountants of England and Wales)

101 Written evidence from Employment Lawyers’ Association ([DFD0108](#))

102 [Q 8](#) (Colin Ben-Nathan, Chartered Institute of Taxation)

103 For example, [QQ 20](#) and [24](#) (Matthew Abraham, Oil and Gas UK), [Q 28](#) (Karen Thomson, Administrative Burdens Advisory Board) and [Q 36](#) (Stephen Ratcliffe, the Employment Lawyers’ Association) and written evidence from the Law Society of Scotland ([DFD0107](#))

104 Written evidence from Federation of Small Business ([DFD0106](#))

105 Written evidence from Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, HM Treasury ([DFD0156](#))

106 [Q 56](#) (Cerys McDonald, HM Revenue and Customs)

107 [Q 36](#) (Keith Gordon)

108 In broad terms, mutuality of obligation exists where the employer is obliged to provide work to the employee and pay for it, and the employee is obliged to do it.

109 Written evidence from Low Incomes Tax Reform Group ([DFD0100](#))

110 [Q 8](#) (Colin Ben-Nathan, Chartered Institute of Taxation)

111 Written evidence from Low Incomes Tax Reform Group ([DFD0100](#))

112 Written evidence from the Recruitment and Employment Confederation ([DFD0123](#))

argued that CEST did address mutuality of obligation, but acknowledged that others disagreed.¹¹³

75. Other witnesses questioned the emphasis that the tool places on substitution rights,¹¹⁴ arguing that such emphasis was “out of kilter” with the case law.¹¹⁵ NHS Digital highlighted “substitution” in CEST as particularly problematic:¹¹⁶
- “The biggest assessment of all is ‘has the contractor got unfettered right of substitution?’ ... in our contracts, we believed that they had that right ... when the CEST tool asked whether contractors had that right, generally we said they had the right of unfettered substitution, but HMRC challenged us on that.”
76. According to the Employment Lawyers’ Association, “it is generally considered that [CEST] applies a higher standard to demonstrate self-employment than is true of applicable case law.”¹¹⁷ As a result, there is a perception that CEST is predisposed to classify contractors as employees.¹¹⁸ Others were even more direct in their criticism. IHPA described CEST as “a glorified flowchart incapable of considering the full factual matrix”, contrasting its necessarily mechanistic approach with the way in which courts seek to “paint a picture from an accumulation of brushstrokes” when determining status.¹¹⁹
77. It is clear that businesses and contractors have little confidence in CEST, even after the recent improvements to the tool. For contractors, this lack of confidence translates in many cases to distrust in the result¹²⁰—and, as IPSE put it, to a fear of being put incorrectly into IR35 and of having to pay more tax than they should. Andrew Chamberlain of IPSE told us that although the draft legislation gave contractors a right of appeal against a client’s status determination if they disagreed with it, this process was “very one-sided”; in reality “it is unlikely that a big client, once it has made a decision, will overturn it simply because the contractor says ‘I think you’ve got this wrong’.”¹²¹
78. For businesses preparing for the new rules, the challenges are different. They are required to take reasonable care in assessing a contractor’s status: failure to do so will lead to increased tax obligations. One industry body was concerned that using CEST by itself might not meet this “reasonable care” requirement. As a result, many of its members were looking to use other tools.¹²²

113 [Q 56](#) (Cerys McDonald, HM Revenue and Customs). For a different view, see, for example, [Q 8](#) (Colin Ben-Nathan, Chartered Institute of Taxation), [Q 14](#) (Andrew Chamberlain, Association of Independent Professionals and the Self-Employed) and [Q 19](#) (Dr Iain Campbell, Independent Health Professionals Association)

114 In broad terms, a contractor with a right of substitution has the right to arrange for someone else to carry out the relevant work in their place.

115 Written evidence from the Association of Independent Professionals and the Self-Employed ([DFD0101](#)) and the Employment Lawyers’ Association ([DFD0108](#))

116 [Q 59](#) (Carl Vincent, NHS Digital)

117 Written evidence from Employment Lawyers’ Association ([DFD0108](#))

118 Written evidence from Cornwallis Elt ([DFD0112](#)) and [Q 20](#) (John McVay, Producers Alliance for Cinema and Television)

119 Written evidence from Independent Health Professionals Association ([DFD0103](#))

120 For example see the written evidence from Mr David Kirk ([collated written evidence from individuals](#)), Ms Lianne Bowie ([collated written evidence from individuals](#)) and Mr Matthew Searle ([collated written evidence from individuals](#)).

121 [Q 17](#) (Andrew Chamberlain, Association of Independent Professionals and the Self-Employed)

122 Written evidence from British Chemical Engineering Contractors Association ([DFD0122](#))

79. CEST does have a major advantage compared with other tools: HMRC will abide by CEST’s results, provided that the information entered is accurate and the tool is used in accordance with HMRC’s guidance. However, witnesses gave two reasons as to why these conditions might be difficult to meet.¹²³ First, CEST is likely to be applied by people without a detailed understanding of the underlying tax rules or the ‘on-the-ground’ facts of the contractor’s working relationship. Second, CEST requires a number of subjective judgements—with the risk that HMRC might ultimately make a different judgement.¹²⁴ As IPSE told us: “There is always the risk that HMRC could come along at a future date and disagree.”¹²⁵
80. **Given that the off-payroll rules do not change the substance of the IR35 status determination requirement, we conclude that HMRC is imposing a heavy burden on businesses by requiring them to determine status using a complex, fact-specific test. We agree with our witnesses that the support offered by HMRC in determining status—and the CEST tool in particular—falls well short of what is required.**

Potential cost to business of the new rules

81. Training in CEST (or any other tool) is only one part of what businesses will need to do to prepare for the proposed changes. HMRC has estimated one-off preparatory costs for business as £14.4 million,¹²⁶ but our evidence suggests that this figure is widely off the mark. Julia Kermode of the FCSA said: “Businesses who are prepared are spending a lot of money”.¹²⁷ By way of example, ICAEW reported that a cumulative total of £3 million had already been spent by six large businesses.¹²⁸ “If this was straightforward and cheap to operate, we would not be seeing large businesses saying ‘we’re not going to deal with PSCs any more’. But they are,” Anita Monteith of ICAEW told us.¹²⁹
82. HMRC submitted evidence on how it calculated the one-off costs to business. It had made various assumptions about how much time businesses would need to prepare for the changes, to which it then applied its Standard Cost Model (a method for determining the administrative burdens on businesses imposed by regulation).¹³⁰ However, Bill Dodwell of the OTS urged caution: “[The Standard Cost Model] has existed for more than 20 years ... there is the general feeling that it is not capable of producing a decent estimate of the private sector costs of adopting whatever measure.”¹³¹

123 For example, [Q 28](#) (Karen Thomson, Administrative Burdens Advisory Board) and written evidence from Cornwallis Elt ([DFD0112](#)) and the Law Society of Scotland ([DFD0107](#))

124 [Q 34](#) (Caroline Colliston, Law Society of Scotland)

125 [Q 4](#) (Andrew Chamberlain, Association of Independent Professionals and the Self-Employed)

126 HM Revenue and Customs policy paper, ‘Rules for off-payroll working from April 2020’ (3 April 2020): <https://www.gov.uk/government/publications/rules-for-off-payroll-working-from-april-2020/rules-for-off-payroll-working-from-april-2020> [accessed 17 April 2020]

127 [Q 13](#) (Julia Kermode, Freelance and Contractor Services Association)

128 Written evidence from Institute of Chartered Accountants of England and Wales ([DFD0097](#)). Similar estimates were given in written evidence from the Employment Taxes Industry Forum ([DFD0121](#)).

129 [Q 5](#) (Anita Monteith, Institute of Chartered Accountants of England and Wales) ([DFD0097](#))

130 Written evidence from HM Revenue and Customs and HM Treasury ([DFD0154](#))

131 [Q 31](#) (Bill Dodwell, Office of Tax Simplification)

83. In the light of the evidence that we received about the costs that businesses have already incurred in preparing for the rules, HMRC committed to revisit its assessment of these costs.¹³²

Business readiness

84. We received a significant amount of evidence about the level of business preparedness. During an oral evidence session with professional bodies representing accountants and business, we heard that delays in publishing HMRC guidance and other support on the new rules, while understandable given the general election, had affected businesses that were preparing for the expected start date of 6 April 2020.¹³³ Other witnesses reported that some businesses, especially medium-sized organisations, had difficulties in ascertaining what the changes would mean for them, and had not yet taken any preparatory steps.¹³⁴
85. **The new rules make no changes to the IR35 test of employment status. In the light of the widely reported complexity of the case law test, this will leave businesses with significant challenges in determining the status of contractors.**
86. **Large- and medium-sized businesses are being made responsible for enforcing a regime which HMRC has struggled with over the last 20 years. Effectively, therefore, the Government is privatising tax compliance.**
87. **We question whether the CEST tool as currently constituted is fit for purpose. It offers limited assistance to businesses, which need to spend considerable time and money clarifying the status of their contractors as a result. We believe that the costs to businesses of implementing the changes have been severely underestimated and that HMRC has not fully understood the impact of these measures. We therefore welcome HMRC's commitment to review the methodology that it uses to model these costs.**

Possible behavioural effects of the new rules

88. Although the extension of the off-payroll rules to the private sector has been deferred to April 2021, our evidence made it clear that the rules were already having an impact on how private sector clients work with contractors. These behavioural effects in part mirror those in the public sector. The evidence suggests that these effects are likely to increase once the rules are implemented.
89. Witnesses told us that many private sector clients were risk-averse. Because the status determinations that the legislation will require them to make are so complex, such businesses are concerned that they will make mistakes, leading to disputes with HMRC and the potential reputational risk of being

132 Written evidence from Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, HM Treasury ([DFD0156](#)); [Q 55](#) (Cerys McDonald, HM Revenue and Customs)

133 [Q 2](#) (Anita Monteith, Institute of Chartered Accountants of England and Wales; Justine Riccomini, Institute of Chartered Accountants of Scotland; and Jason Piper, Association of Chartered Certified Accountants); [Q 13](#) (Abigail Agopian, Confederation of British Industry); and written evidence from the Employment Taxes Industry Forum ([DFD0102](#))

134 Written evidence from Low Incomes Tax Reform Group ([DFD0100](#)) and Freelance and Contractor Services Association ([DFD0102](#)), and [Q 27](#) (Karen Thomson, Administrative Burdens Advisory Board)

publicly associated with an area which HMRC refers to as tax avoidance. ACCA said: “Regardless of its confidence in its own assessments ... the risk to the business lies in HMRC taking the case to a public hearing”.¹³⁵

90. We heard that organisations were attempting to manage this risk in two ways. First, some large private sector clients have reacted by deciding not to use freelance contractors at all.¹³⁶ A number of high-profile companies in the banking, oil and pharmaceutical sectors have taken this approach. The FCSA told us that 18% of respondents to a survey in February 2020 conducted by a large recruitment firm, SThree, said that their clients had “banned” personal service companies.¹³⁷ In so doing, these companies effectively sidestepped the legislation. inniAccounts Ltd explained: “Not only have these engagers banned workers using PSCs who engage directly with them (or via an agent); they have also mandated that all suppliers, regardless of size, discontinue the use of PSC workers”, though for larger companies there may be no other reasonable means to mitigate the tax risk of the changes.¹³⁸
91. Second, companies appear to have already started blanket-assessing contractors as within IR35, mirroring the blanket assessments that were made when the off-payroll rules were introduced in the public sector in 2017.¹³⁹ Private sector clients may judge that, given its limited resources, HMRC is unlikely to investigate too closely where it decides that the off-payroll legislation applies.
92. In view of the risk of being branded trouble-makers or adversely affecting their chances of being offered work again, in practice many contractors are likely to be unwilling to dispute status determinations. Hydrogen Group plc told us: “The commercial reality is that the challenge process won’t be used as PSCs would fear contract termination should they make a challenge to status determination.”¹⁴⁰ ICAS reported anecdotal evidence from its members that many large-scale recruitment businesses and umbrella companies were preparing status determination statements ahead of the new rules taking effect, in order to forestall appeals.¹⁴¹

Umbrella companies

93. Another possible behavioural effect anticipated by witnesses and foreshadowed by the public sector experience is the increased use of umbrella companies.¹⁴² This effectively passes some of the compliance burdens that would otherwise apply to clients to the umbrella company. While there are many compliant umbrella companies operating in the UK, witnesses expressed concern that

135 Written evidence from Association of Chartered Certified Accountants ([DFD0098](#))

136 Written evidence from the Recruitment & Employment Confederation ([DFD0123](#)), British Chemical Engineering Contractors Association ([DFD0122](#)), Hydrogen Group plc ([DFD0119](#)) Cornwallis Elt ([DFD0112](#)) and Mr Christopher Lopez-Smith ([collated written evidence from individuals](#))

137 [Q 13](#) (Julia Kermode, Freelance and Contractor Services Association)

138 Written evidence from inniAccounts Ltd ([DFD0118](#))

139 Written evidence from the Recruitment & Employment Confederation ([DFD0123](#)), Association of Chartered Certified Accountants ([DFD0098](#)), Mr Ben Knibbs ([collated written evidence from individuals](#)) and [Q 4](#) (Jason Piper)

140 Written evidence from Hydrogen Group plc ([DFD0119](#))

141 Written evidence from the Institute of Chartered Accountants of Scotland ([DFD0099](#))

142 Written evidence from British Chemical Engineering Contractors Association ([DFD0122](#)), Cornwallis Elt ([DFD0112](#)), Freelance and Contractor Services Association ([DFD0102](#)), Association of Independent Professionals and the Self-Employed ([DFD0101](#)), the Recruitment & Employment Confederation ([DFD0123](#)), Mr Philip Beardwood ([collated written evidence from individuals](#)), Mr Colin George ([collated written evidence from individuals](#)) and Mr Ahmed Khan ([collated written evidence from individuals](#))

the changes might lead to a growth in non-compliant umbrella companies. Morson Group plc, a recruitment business, told us of a risk of “less scrupulous agencies” taking advantage of contractors looking to maintain levels of take-home pay by promising “too good to be true” solutions.¹⁴³ These solutions could include loan schemes (notwithstanding the recent Government action on such schemes).¹⁴⁴

94. Lower-paid workers were viewed as particularly at risk from unscrupulous umbrella companies: LITRG was concerned about contractors at the lower end of the scale being misled into arrangements that they did not understand. We heard that one of the outcomes of the public sector changes was “a well-documented mass shift of people out of [limited companies] into highly aggressive umbrella company models”. Witnesses told us that they would welcome engagement with HMRC about ways of managing the risk posed by non-compliant umbrella companies.¹⁴⁵
95. The Financial Secretary to the Treasury told us that the Government was committed to expanding the remit of the Employment Agency Standards Inspectorate to cover umbrella companies. He reported that HMRC had recognised umbrella companies as a strategic risk in its compliance plan, and that it had a number of umbrella companies under investigation. He wrote that HMRC would continue to monitor the role of umbrella companies.¹⁴⁶
96. Where contractors are brought within the off-payroll working rules, payments to them will be affected, as the umbrella company will deduct tax and NICs. We heard that many engagers plan to renegotiate contracts to pass the costs of employers’ National Insurance Contributions and the Apprenticeship Levy to contractors.¹⁴⁷
97. It is not clear whether HM Treasury and HMRC anticipated the behavioural consequences that we have outlined; they have tended to dismiss blanket-assessing in the public sector on the basis of the IFF research that we discussed in chapter 3.¹⁴⁸
98. **Since both clients and contractors have driven the increase in the use of personal service companies and benefited from the resulting tax treatment, it seems unfair that the contractor will effectively bear the brunt of the client’s National Insurance Contributions in addition to their own, greater, employment taxes.**
99. **We received clear evidence that the blanket status assessments made in the public sector following the IR35 reforms there were being replicated in the private sector in advance of the private sector rules being implemented.**

143 Written evidence from Morson Group plc ([DFD0114](#))

144 Finance (No 2) Act 2017, see [section 34](#) and [schedule 11](#)

145 Written evidence from Low Income Tax Reform Group ([DFD0100](#)) and [QQ 7](#) and [10](#) (Meredith McCammond, Low Incomes Tax Reform Group) and [Q 16](#) (Julia Kermode, Freelance and Contractor Services Association)

146 Written evidence from Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, HM Treasury ([DFD0156](#))

147 Written evidence from InnAccounts Ltd ([DFD0118](#))

148 See joint written evidence from HM Revenue and Customs and HM Treasury ([DFD0154](#)).

100. **We also heard that some organisations, many of them large businesses, are already refusing to engage any freelance contractors—and are thereby side-stepping the new rules.**
101. **We call on HMRC to engage more with business and tax professional bodies about the risks associated with engaging umbrella companies.**
102. **While it is not possible to quantify the potential behavioural effects of the new rules, our evidence was remarkably consistent in suggesting that any such behavioural consequences risk an adverse impact on the economy. We agree with this analysis, and urge the Government to carry out a full assessment of how its proposals will affect the decisions that businesses and contractors make.**

Possible labour market impacts

103. The 2018 Government consultation document, *Off-payroll working in the private sector*, said:
- “The Government recognises that the UK’s flexible labour market supports job creation and allows more people to participate in work. The option to work through an intermediary, including a PSC, helps support this labour market.”¹⁴⁹
104. In February of this year the report on the Government’s review of the implementation of the private sector changes argued:
- “Allowing individuals and businesses to agree working arrangements to suit their needs is an important pillar of the labour market’s success and the Government is committed to retaining that flexibility.”¹⁵⁰
105. Our witnesses agreed. ICAEW told us: “We know that we enjoy and are lauded for having a very good contract workforce in the UK. It is very flexible. We would not want to throw that away.”¹⁵¹ The Hydrogen Group plc described the UK as “the envy of the world with its flexible labour market working for the economy, organisations and individuals”.
106. However, the behavioural effects discussed above suggest that the new off-payroll working rules have distorted recruitment decisions in the private sector and restricted the options open to freelance contractors. We heard that the roll-out of the off-payroll rules in the public sector had been disruptive to the supply of labour.¹⁵² NHS Digital told us that, in the initial period after their introduction, the labour market was unsettled.¹⁵³
107. Witnesses reported that the options available to contractors who did not wish to be within the scope of these rules were limited. ICAEW said:

149 HM Revenue and Customs, consultation document, *Off-payroll working in the private sector* (18 May 2018): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/708544/Off-payroll_working_in_the_private_sector_-_consultation_document.pdf [accessed 17 April 2020]

150 HM Revenue and Customs, *Review of changes to the off-payroll working rules: report and conclusion*, (27 February 2020): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/867519/20-02-19_-_FINAL_Off-payroll_Review_Document.pdf [accessed 17 April 2020]

151 **Q 5** (Anita Monteith, Institute of Chartered Accountants of England and Wales)

152 Written evidence from Morson Group (**DFD0114**), Association of Professional Staffing Companies, (**DFD0110**), Hays Recruitment Consultancies (**DFD0136**) and SThree Group (**DFD0116**)

153 **QQ 58** and **60** (Carl Vincent, NHS Digital)

“We have seen, in the public sector, mass movement into the private sector. Are we now going to see, in the private sector, people moving to work for small entities only? That is doubtful: I do not think there is sufficient work in the small sector. Will they go abroad? Quite possibly.”¹⁵⁴

108. We were told that, for the most skilled and in-demand contractors, working abroad could be particularly attractive.¹⁵⁵ John McVay of PACT thought that there were “plenty of other competing countries” interested in attracting contractors working in the creative industries.¹⁵⁶ StopIR35’s survey found that 28% of contractors had considered or were actively planning to work overseas.¹⁵⁷
109. There are potential risks for contractors who decide to stay in the UK, which seem likely to reduce the market’s current flexibility. As discussed above, some clients have decided to bring contractors in-house as employees—on different (and likely less favourable) financial terms. Although some contractors may welcome this—as they will also benefit from employment rights—many value their independence as contractors and have no interest in employment.¹⁵⁸ As we outlined earlier, there is also the risk that clients pass on to contractors the cost of employers’ National Insurance Contributions and the Apprenticeship Levy.¹⁵⁹
110. We heard that some clients plan to offshore work in response to the new rules (StopIR35’s survey indicated that 9% of contractors saw their work being moved offshore), meaning that some roles will effectively disappear.¹⁶⁰ Taken together, these impacts may mean that some contractors are forced out of freelancing altogether and may not be able to find alternative employment.
111. At the other end of the scale, those contractors who are most in-demand might be able to raise their rates, thereby increasing business costs. John McVay of PACT told us: “We worry considerably, not just in my sector but across the creative industries, that the change will be inflationary.”¹⁶¹ Members of the British Chemical Engineering Contractors Association (BCECA) saw “pay rates for critical contractors working on Crossrail being increased by nearly 50% to ‘compensate’ workers being brought inside IR35”.¹⁶² Other witnesses were concerned about a decline in the supply of flexible, skilled labour that has previously benefitted the UK.¹⁶³
112. At this stage these concerns are necessarily speculative, but they are supported by experiences in the public sector over the last three years. NHS Digital described what the public sector changes had meant for its

154 [Q 5](#) (Anita Monteith, Institute of Chartered Accountants of England and Wales) and see written evidence Prof Patricia Leighton ([DFD0111](#)) and Ms Amelia Berriman ([collated written evidence from individuals](#))

155 Written evidence from British Chemical Engineering Contractors Association ([DFD0122](#))

156 [Q 20](#) (John McVay, Producers Alliance for Cinema and Television)

157 Written evidence from StopIR35 ([DFD0096](#))

158 Written evidence from Prof Patricia Leighton ([DFD0111](#))

159 Written evidence from InniAccounts Ltd ([DFD0118](#)) and the Stop the Off-Payroll Tax campaign ([DFD0143](#))

160 Written evidence from Cornwallis Elt ([DFD0112](#)), Stop the Off-Payroll Tax campaign ([DFD0143](#)) and StopIR35 ([DFD0096](#))

161 [Q 19](#) (John McVay, Producers Alliance for Cinema and Television)

162 Written evidence from British Chemical Engineering Contractors Association ([DFD0122](#))

163 Written evidence from the Federation of Small Business ([DFD0106](#)), Stop the Off-Payroll Tax Campaign ([DFD0143](#)) and Association of Independent Professionals and the Self-Employed ([DFD0101](#))

contractor relationships.¹⁶⁴ Although the market had settled down after initial disruption (and the organisation was now able to find workers to meet their needs), the new rules still brought costs, both for them and their workers. Where NHS Digital classified a worker as inside IR35, there was no increase in contract rates (because contractors were engaged through an umbrella company, it was likely that their take-home pay was reduced by employers' NICs)—and so some contractors left. But for contractors whom they particularly wanted to retain, NHS Digital increased payrates. As with the other behavioural changes that we have described, it is likely that private sector organisations, like their public sector counterparts, will have to pay more to keep their most valued contractors when the off-payroll rules are implemented.

113. Lindsey Whyte of HM Treasury told us: “We are not expecting a very significant shift in the supply or demand for contingent labour,”¹⁶⁵ while HMRC did not expect any significant macro-economic effect.¹⁶⁶ Its view was that the changes were simply about status classification.¹⁶⁷ This approach may be complacent. It is likely that the changes will unsettle the labour market, as happened in 2017, though it may be that the market adapts to a new equilibrium in the medium to longer term, such that HM Treasury’s assessment is ultimately borne out.
114. **In the short term at least, it is likely that the off-payroll changes will cause disruption to the UK’s labour market. We are therefore concerned that the outcomes of extending off-payroll working to the private sector seem to have been assessed primarily in terms of increasing compliance. The Government needs to consider the damage that may be done to the diversity and flexibility of the labour market. Any future review of the impact of the measures must take into account the wider impact of the changes on the UK’s labour market and the broader economy.**

Policy objectives of the proposed changes

115. There are three connected policy objectives behind the extension of the off-payroll working rules to the private sector: improving compliance with existing legislation, protecting the tax base and promoting fairness in tax treatment.

Compliance with existing legislation

116. The report on the recent review of the implementation of the off-payroll rules in the private sector argued: “Non-compliance with the off-payroll working rules is widespread and is forecast to cost the Exchequer £1.3 billion by 2023/24, if not addressed.”¹⁶⁸ HMRC has admitted that it has been unable to police the IR35 rules adequately because the need to consider contracts individually in order to check compliance is very resource-intensive. It does not plan to increase its compliance activities in this area, because the yield

164 Q 60 (Carl Vincent, NHS Digital)

165 Q 54 (Lindsey Whyte, HM Treasury)

166 See joint written evidence from HM Revenue and Customs and HM Treasury (DFD0154)

167 Q 57 (Lindsey Whyte, HM Treasury)

168 HM Revenue and Customs, Review of changes to the off-payroll rules: report and conclusions (27 February 2020): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/867519/20-02-19_-_FINAL_Off-payroll_Review_Document.pdf [accessed 16 April 2020]

per contractor is insufficient to justify the investment, and limited resources could be used more effectively elsewhere.¹⁶⁹

117. HMRC claims that only one in 10 of the contractors who should be within the IR35 rules is currently applying them. HMRC sent us an explanation of how it had arrived at that figure,¹⁷⁰ which many witnesses had questioned.¹⁷¹ While we query how much confidence can be placed in HMRC's figures, its assessment seems to have been borne out by the experience of NHS Digital.¹⁷² There are a number of reasons for poor compliance. Many PSCs may have found the rules difficult to understand. Others lacked the incentive to apply them rigorously if this would result in their being taxed more heavily—particularly when they deemed it unlikely that their failure to operate the rules correctly would be picked up by HMRC. The 2018 consultation document *Off-payroll working in the private sector* acknowledged this aspect: “For many off-payroll engagements, to which the rules should apply, there is a perception that there is a very limited chance of enquiries being opened by HMRC.”¹⁷³
118. In a similar vein, the FCSA commented: “The proposed changes to off-payroll working would not be under consideration if HMRC adequately enforced their existing powers”, concluding: “It seems quite wrong that HMRC is effectively delegating its enforcement role to businesses.”¹⁷⁴ The Employment Lawyers' Association agreed: “That is the very point of the reforms. The Revenue does not have the capacity to investigate 400,000 personal service company contractors.”¹⁷⁵
119. As we have shown, transferring responsibility for operating the rules from contractors to clients has in fact shifted responsibility for ensuring that the rules are applied away from HMRC, first to public sector engagers, and now to large- and medium-sized businesses in the private sector. We heard that private sector engagers were concerned to get IR35 right, and arguably are in a better position to do so than contractors.¹⁷⁶ However, this must be balanced against the financial cost to businesses, and the cost to their relationships with engagers.¹⁷⁷
120. Nevertheless it is likely that the changes will indeed bring greater compliance with the rules. Businesses will wish to avoid coming into conflict with HMRC, and the risks associated with not following the rules—particularly

169 HM Revenue and Customs, consultation document, *Off-payroll working in the private sector* (18 May 2018): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/708544/Off-payroll_working_in_the_private_sector_-_consultation_document.pdf [accessed 17 April 2020]

170 Q 54 (Cerys McDonald, HM Revenue and Customs); see also joint written evidence from HM Revenue and Customs and HM Treasury (DFD0154)

171 See, for example, Q 18 (Andrew Chamberlain, Association of Independent Professionals and the Self-Employed)

172 Q 58 (Carl Vincent, NHS Digital)

173 HM Revenue and Customs, consultation document, *Off-payroll working in the private sector* (18 May 2018): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/708544/Off-payroll_working_in_the_private_sector_-_consultation_document.pdf [accessed 17 April 2020]

174 Written evidence from the Freelance and Contractor Services Association (DFD0102)

175 Q 39 (Stephen Ratcliffe, Employment Lawyers' Association)

176 Q 19 (John McVay, Producers Alliance for Cinema and Television), Q 9 (Colin Ben-Nathan, Chartered Institute of Taxation), and written evidence from British Chemical Engineering Contractors Association (DFD0122), the Employment Taxes Industry Forum (DFD0121) and the Law Society of England and Wales (DFD0138)

177 For example, Q 27 (Bill Dodwell, Office of Tax Simplification)

the risks that they will have to operate PAYE and pay NICs—will incentivise compliance. Indeed, many witnesses were concerned that businesses’ aversion to risk might result in more contractors being brought within the scope of the rules than should be there.

Protecting the tax base

121. The Government’s report on the recent review said:

“It is widely accepted that the rules introduced in 2000 have not been fully effective. Many have called for them to be scrapped but successive Governments have been clear that these rules are essential to protect the tax base.”¹⁷⁸

122. The need to protect the tax base relates to HMRC’s assessments that nine out of ten contractors who should currently be within IR35 are not applying the rules correctly and that the loss of tax could grow to £1.3 billion. Given the quality of the underlying data, it is difficult to gauge how much confidence there should be in these figures—though they seem to be the best available. At Budget 2018 the Office for Budget Responsibility (OBR) gave HMRC’s assessment of additional revenues from the changes a high uncertainty rating.¹⁷⁹ The Financial Secretary to the Treasury said that the Government stood by the methodology used to cost its policy, which had been re-costed at Budget 2020 and certified by the OBR. The proposals are now expected to raise £4.1 billion by 2024/25.

123. A large number of witnesses believed that the reason for the changes was to increase tax revenues. It is likely that the tax take will go up, as it has in the public sector, subject to the effects of the new rules on the labour market that we discussed above. But increasing compliance and tax revenues could also bring more mis-categorisation—as the public sector reforms showed.

124. **We agree with our witnesses that revenue-raising is the major driver of the proposed changes. According to HMRC’s own forecasts, improved compliance could bring as much as £4.1 billion by 2024/25 to the Exchequer. The value of this potential tax take requires any measures to improve compliance to work effectively for contractors, clients and HMRC.**

Fairness

125. The report on the recent review stated: “It is fair that individuals who work in a similar way should pay broadly the same amount of tax.”¹⁸⁰ While our witnesses agreed that contractors should pay an appropriate amount of tax, they challenged the concept of fairness as set out in the consultations on

178 HM Revenue and Customs, Review of changes to the off-payroll rules: report and conclusions (27 February 2020): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/867519/20-02-19_-_FINAL_Off-payroll_Review_Document.pdf [accessed 16 April 2020]

179 The Office for Budget Responsibility reported that the estimates were dependent on a number of assumptions about the behaviour of affected taxpayers.

180 HM Revenue and Customs, Review of changes to the off-payroll rules: report and conclusions (27 February 2020): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/867519/20-02-19_-_FINAL_Off-payroll_Review_Document.pdf [accessed 16 April 2020]

the proposed changes.¹⁸¹ In particular they felt that the rules would create a new class of workers who were employees only for tax purposes, but with none of the rights that employees can expect—what some witnesses described as “zero-rights employment”—while shouldering all the risk of workforce flexibility.¹⁸² These witnesses believed that such a situation would be “unfair”. They told us that employment status for tax should be aligned with employment status more generally.¹⁸³ “Fairness” should not be confined to tax alone.

126. Moreover, being taxed as an employee would not take account of additional factors such as the greater uncertainty and risk that contractors face compared with employees, the expenses that they have to meet, and the overheads of personal service companies.
127. **HMRC has acknowledged the challenges that IR35 has faced in improving compliance. However, under the new rules IR35 itself will not change. Instead businesses will now have to shoulder the compliance challenge. We share the concerns of our witnesses that the rules put too great a burden on businesses.**
128. **We expect compliance with the off-payroll working rules to improve when responsibility passes to large- and medium-sized businesses, and that the tax take will increase as a result. However, we are apprehensive that some contractors will wrongly be categorised as within the rules.**
129. **It is unfair that contractors within the rules are treated as employees for tax purposes but do not qualify for employment rights, thus creating a class of “zero-rights employees”. The Government is replacing one unfairness with another.**
130. **Flexible working by contractors is a legitimate and important part of the UK labour market. However, contractors are in a different category to employees, and should therefore be treated differently. Unless the Government accepts this distinction, the off-payroll rules could eliminate by stealth contractor flexible working, or force contractors to use umbrella companies without adequate legislative protection. Both outcomes would be unacceptable.**

181 Written evidence from Independent Health Professionals Association ([DFD0103](#)), Association of Independent Professionals and the Self-Employed ([DFD0101](#)), Stop the Off-Payroll Tax Campaign ([DFD0143](#)), Recruitment and Employment Confederation ([DFD0123](#)), Cornwallis Elt ([DFD0112](#)), Association of Professional Staffing Companies Ltd ([DFD0110](#)), TaxAssist Direct Ltd ([DFD0113](#)), SThree Group PLC ([DFD0116](#)) and [Q 18](#) (Julia Kermode, Freelance and Contractor Services Association)

182 Written evidence from Cornwallis Elt ([DFD0112](#)) and see also [Q 5](#) (Justine Riccomini, Institute of Chartered Accountants of Scotland), Mr Philip Beardwood ([collated written evidence from individuals](#)), Mr Steven Harrison ([collated written evidence from individuals](#)), Mr Colin George ([collated written evidence from individuals](#)) and [Q 47](#) (Siobhan Endean, Unite)

183 Written evidence from Independent Health Professionals Association ([DFD0103](#)), Association of Independent Professionals and the Self-Employed ([DFD0101](#)), Stop the Off-Payroll Tax Campaign ([DFD0143](#)), Recruitment and Employment Confederation ([DFD0123](#)), Cornwallis Elt ([DFD0112](#)), Association of Professional Staffing Companies Ltd ([DFD0110](#)), TaxAssist Direct Ltd ([DFD0113](#)) and SThree Group PLC ([DFD0116](#)), [Q 18](#) (Julia Kermode, Freelance and Contractor Services Association)

Review of implementation

131. During the 2019 general election campaign all the main political parties committed to reviewing the off-payroll working reforms. On 7 January 2020 the new Government launched a review of the private sector off-payroll changes, but it was limited to issues around implementation¹⁸⁴—and was to be completed in a short timeframe, by mid-February. When announcing the review the Government made clear that the reforms would still come into force on 6 April 2020.¹⁸⁵
132. The report setting out the review’s conclusions, published on 27 February 2020, summarised issues that the Government had identified and the steps that HMRC would take in response.¹⁸⁶ These included a small number of technical changes to the draft legislation, one of which had already been announced.¹⁸⁷ Witnesses told us that the changes were welcome.¹⁸⁸
133. On the same day as the report, HMRC published its planned compliance strategy for the proposed rules,¹⁸⁹ promising to take a “light touch” to penalties in the first 12 months—the so-called “soft-landing” that the Chancellor had promised shortly before the review was completed.¹⁹⁰ Although this offered our witnesses some reassurance, they told us that it was likely to be limited in its effect. In the assessment of one witness, once one “scratched beneath the surface” of the reforms,¹⁹¹ the commitment was not “worth a great deal other than a few good headlines”.¹⁹²
134. The report noted that HMRC had recently published updated guidance on certain aspects of the new rules. Witnesses told us that final, detailed guidance for businesses preparing for the rules was important,¹⁹³ so this announcement was welcomed. However, we heard that businesses would have preferred such guidance to have been published much earlier.¹⁹⁴
135. HMRC also committed to carrying out external research on the impact of the reforms in October 2020, six months after the rules were originally planned to come into effect. Because the private sector reforms have been

184 HM Revenue and Customs, Press Release: ‘Off-payroll review launched’ (7 January 2020): <https://www.gov.uk/government/news/off-payroll-review-launched> [accessed 17 April 2020]

185 HM Revenue and Customs, Press Release: ‘Off-payroll review launched’ (7 January 2020): <https://www.gov.uk/government/news/off-payroll-review-launched> [accessed 17 April 2020]

186 HM Revenue and Customs, Review of changes to the off-payroll rules: report and conclusions (27 February 2020): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/867519/20-02-19_-_FINAL_Off-payroll_Review_Document.pdf [accessed 16 April 2020]

187 HM Revenue and Customs, Press Release: ‘HMRC announces change to the off-payroll working rules’ (7 February 2020): <https://www.gov.uk/government/news/hmrc-announces-change-to-the-off-payroll-working-rules> [accessed 17 April 2020]

188 For example, [Q 2](#) (Jason Piper, Association of Chartered Certified Accountants) and [Q 35](#) (Stephen Ratcliffe, the Employment Lawyers’ Association)

189 HM Revenue and Customs, HMRC’s compliance approach to the 2020 reform of the off-payroll working rules (27 February 2020): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/867280/20200219_Off-payroll_HMRC_compliance_strategy.pdf [accessed 17 April 2020]

190 ‘Rishi Sunak promises to be fair over IR35 tax changes’, Financial Times (24 February 2020): <https://www.ft.com/content/0f9bb8d2-564b-11ea-abe5-8e03987b7b20> [accessed 21 April 2020]

191 [Q 35](#) (Keith Gordon)

192 [Q 35](#) (Keith Gordon)

193 For example, [QQ 13](#) and [16](#) (Abigail Agopian, Confederation of British Industry)

194 [Q 2](#) (Jason Piper, Association of Chartered Certified Accountants), [Q 10](#) (Colin Ben-Nathan, Chartered Institute of Taxation) and [Q 30](#) (Karen Thomson, Administrative Burdens Advisory Board) and written evidence from Cornwallis Elt ([DFD0112](#))

delayed, this commitment will now apply from October 2021.¹⁹⁵ External research on the public sector reforms was also carried out after six months. But the evidence that we heard about the public sector reforms research suggests that research carried out six months after the private sector reforms' introduction would come too soon to give a full and accurate picture of their effects.

136. **The Government's review of the private sector reforms came barely weeks before the rules' planned implementation, and had a very short timetable and narrow remit. There was limited scope for proper consideration of stakeholders' concerns about the new rules—and less scope for proposing material changes.**
137. **HMRC's publication of updated guidance on the new rules is welcome, but it is regrettable that guidance on key aspects of the rules was published only six weeks before their expected commencement.**
138. **While we welcome the Government's commitment to commissioning external research into the impact of the reforms, the proposal that this research be carried out six months after the rules' implementation does not give enough time to measure the true impact of the reforms. HMRC should defer any such research until 18 months after the rules have been in operation.**

Deferral of the off-payroll working rules to 2021

139. At the Budget on 11 March 2020, the Government confirmed that the off-payroll rules would be introduced to the private sector on 6 April 2020.¹⁹⁶ However, a few days later, on 17 March 2020, it announced that the start date for these rules would be deferred to 6 April 2021 as part of its additional support to businesses to help them deal with the economic impact of the COVID-19 pandemic.¹⁹⁷
140. The Financial Secretary to the Treasury told us afterwards: "This is a deferral of the introduction of the reforms, not a cancellation".¹⁹⁸ He wrote that the Government remained committed to introducing the rules, with the relevant legislation to be included in this year's Finance Bill.¹⁹⁹
141. **Towards the end of our inquiry the scale of the adverse economic effects of the COVID-19 pandemic became clearer, as well as the restrictions imposed by the Government in response and what they might mean for business. This is the greatest shock that the UK's economy has experienced since the Second World War.**
142. **We welcome the Government's decision to postpone the start date for extending the off-payroll rules to the private sector to April 2021.**

¹⁹⁵ Written evidence from Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, HM Treasury ([DFD0156](#))

¹⁹⁶ HM Treasury, Budget 2020 (March 2020), paragraph 2.178: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/871799/Budget_2020_Web_Accessible_Complete.pdf [accessed 17 April 2020]

¹⁹⁷ Written evidence from Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, HM Treasury ([DFD0156](#))

¹⁹⁸ Written evidence from Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, HM Treasury ([DFD0156](#))

¹⁹⁹ The provisions implementing the reforms were not included in the draft Finance Bill published on 19 March 2020.

A deferral is necessary, but business is likely to need considerably longer than a year to recover from the disruption caused by the COVID-19 pandemic. It is right not to impose unnecessary burdens on business at such a difficult time.

143. **A delay gives time for further consideration. The Government should commission an independent review of the introduction of the off-payroll rules in the public sector and undertake an analysis of how introducing off-payroll rules to the private sector will affect the labour market. In addition, the delay provides time to tackle the ongoing deficiencies of CEST and the status determination process, and to revisit the Government's assessment of the costs to business of the proposals, which our evidence shows were significantly underestimated.**
144. **The extra time should also be used to consider alternatives to the off-payroll rules that are fairer and less risky, and which do not treat individuals as employees for tax purposes when they do not enjoy the rights of employees. Once completed, the Government should present Parliament with a clear strategy to address the issue of fairness in the tax system and foster a flexible workforce in which contractors play a vital role.**
145. **To give certainty to business, the Government should announce by October 2020 whether it will indeed implement the off-payroll rules in April 2021, or whether any on-going impact to the economy resulting from the COVID-19 pandemic will require their implementation to be delayed further.**

CHAPTER 5: ALTERNATIVES TO THE OFF-PAYROLL WORKING RULES

146. Justine Riccomini of ICAS reflected the views of many other witnesses when she concluded: “IR35 was conceived 20 years ago. It was a sickly child when it was conceived and I do not think it has got any better along the way.”²⁰⁰ Other witnesses agreed that IR35 and the off-payroll working rules had not improved, and suggested alternatives. They drew our attention to the various proposals made to HMRC as part of its consultation process, and recommendations made by the OTS and the *Taylor Review of modern working practices* on employment status. Without reaching a judgement on their merits, we rehearse some of these ideas briefly in this chapter, to illustrate the range of alternative possibilities.

The Government’s view of alternative approaches

147. The discussion document on IR35 issued by the Government in 2015 stated that “the Government would ... welcome views on alternative options for more fundamental reform”. It made clear that any alternative would have to meet the objectives of both protecting the Exchequer and levelling the playing field between employees and those who would be employed directly, if they were not operating through their own company.²⁰¹ Similarly, the May 2018 consultation document dealing with the extension of the off-payroll working rules to the private sector said: “We would welcome suggestions on the best options to address this problem and better protect the Exchequer while ensuring fairness between taxpayers.”
148. However, in the 2016 consultation on reforming how IR35 applied in the public sector,²⁰² all the suggestions that had been made to HMRC following the publication of the 2015 discussion document were ruled out.²⁰³ These had included linking the application of the rules to the length of contract to give businesses a much simpler test to apply when determining who was in scope, and a new withholding tax on payments to PSCs. In addition, the 2018 consultation document specifically ruled certain options out of scope. As a result, in the response document to the consultation, other suggestions were ruled out of scope or dismissed for other reasons.²⁰⁴

200 Q 5 (Justine Riccomini, Institute of Chartered Accountants of Scotland)

201 HM Revenue and Customs, Intermediaries legislation (IR35): Discussion Document (17 July 2015): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/446242/Intermediaries_legislation_IR35-discussion_document.pdf [accessed 7 April 2020]

202 HM Revenue Customs, Off-payroll working in the public sector: reform of the intermediaries legislation (26 May 2016): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/526614/Off-payroll_working_public_sector-reform_intermediaries_legislation.pdf [accessed 17 April 2020]

203 HM Revenue Customs, Off-payroll working in the public sector: reform of the intermediaries legislation (26 May 2016), chapter 6: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/526614/Off-payroll_working_public_sector-reform_intermediaries_legislation.pdf [accessed 17 April 2020]

204 HM Revenue Customs, Off-payroll working in the private sector: summary of responses (29 October 2018): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752160/Off-payroll_working_in_the_private_sector_-_summary_of_responses.pdf [accessed 17 April 2020]

149. The Government was clear that its existing method for addressing compliance issues was the “right approach”.²⁰⁵ HMRC told us:

“Any alternative ideas that created a new tax regime or different tax treatment for contractors which still allowed them to work like employees but be taxed in a different or advantageous way to employees was ruled out on the basis that it still resulted in unfairness in the tax system.”²⁰⁶

150. **We do not believe that its resistance to alternative approaches has served the Government well. The more intractable and difficult the problem, the more the Government needs to be flexible and open to a range of ways of tackling it. Yet the Government continues to focus on the off-payroll proposals—which are substantially the same as the existing IR35 rules, with all their inherent problems—as the only solution.**

Alternatives proposed by witnesses

A flat-rate withholding tax

151. This proposal was for tax at a flat rate to be deducted from payments to contractors that used a PSC to be paid to HMRC. BCECA wrote:

“An ‘on account’ tax withheld from all fee payers in respect of gross payment to PSCs ... would be reported on the quarterly intermediaries’ report and could be paid on account to HMRC as an advance payment against a self-employed worker’s tax bill.”²⁰⁷

152. The FCSA suggested that “the withholding would be a simple process to enable the upfront collection of taxes which are then reconciled at the end of the year”.²⁰⁸ A withholding tax would provide HMRC with information about payments to PSCs, assisting it with compliance. It could be similar to the Construction Industry Scheme (CIS), which provides for the deduction of tax from payments to construction workers. The PSC would retain responsibility for determining status under IR35 and the amount withheld could then be offset against the PSC’s tax liability.

Freelancer limited company (FLC)

153. This idea was developed by IPSE in partnership with EY. ‘FLCs’ would be ordinary limited companies which chose to operate under particular restrictions to qualify for specific tax treatment. The restrictions would be designed to minimise the tax savings that could otherwise arise for an individual working through a PSC. Only companies with a single shareholder that had a set minimum level of capital would be eligible. To qualify, the FLC would need to meet a minimum salary requirement and dividend frequency restriction, which should ensure a certain level of taxable employment income. Such companies would annually self-certify their compliance with the rules.

205 HM Revenue and Customs, Off-payroll working in the private sector: summary of responses (29 October 2018): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752160/Off-payroll_working_in_the_private_sector_-_summary_of_responses.pdf [accessed 17 April 2020]

206 Joint written evidence from HM Revenue and Customs and HM Treasury (DFD0154)

207 Written evidence from British Chemical Engineering Contractors Association (DFD0122)

208 Written evidence from Freelance and Contractor Services Association (DFD0102)

154. This approach is designed to provide certainty to the PSC and its worker about tax and employment status and, because the restrictions are intended to prevent disguised employment, it would protect revenue for the Exchequer.
155. The OTS considered this idea in 2015 as part of its employment status consultation (see para 169) and again in its 2016 Small Company Taxation Review, where it concluded: “If the criteria for the FLC are properly set [this approach] could deliver certainty (and hence simplicity) to a large body of freelancers and contractors.”²⁰⁹

A levy on using contractors, or ‘engagers’ tax’

156. The idea of a levy on engagers was proposed by the think tank Demos in its 2018 report *Free radicals*: “The Government should introduce a new ‘engagers’ tax’. This would initially be levied at 2.5% on a given firm’s annual expenditure on contracted self-employed labour, rising to 5% in 2021 and 7.5% by [2022].”²¹⁰
157. This proposal has the advantage of simplicity and flexibility since the rate of levy could be adjusted to collect the appropriate amount of tax. As a result, Demos suggested that it was fairer and less of an administrative burden than IR35.²¹¹ It would operate in a similar way to employers’ NICs. In some ways, it would compensate for the fact that clients were not paying employers’ NICs in relation to PSCs.
158. Morson Group plc commented on the advantages of such a levy:

“Following recent changes to the taxation of dividends it is likely that any loss in tax/NICs receipts due to PSC use is largely due to differences in NICs, which create an incentive to avoid employment arrangements. It would be much easier to simply apply a levy of some kind on the use of PSCs to make up for this difference.”²¹²

159. Stop the Off-Payroll Tax campaign also supported a levy.²¹³
160. We heard variations on this proposal. One was for a levy on both contractors and engagers.²¹⁴ The other was to charge employer NICs on payments to PSCs.²¹⁵

Addressing the difference in NIC rates for the employed and self-employed

161. Some witnesses felt that the root of the problem with the use of PSCs was the lack of employers’ NICs in respect of contractors.²¹⁶ They suggested that looking again at the difference between NIC rates for the employed

209 Office of Tax Simplification, Employment status report (March 2015): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/537432/OTS_Employment_Status_report_March_2016_u.pdf [accessed 16 April 2020]; Office of Tax Simplification, Small company taxation review, (2016): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/504850/small_company_taxation_review_final_03032016.pdf [accessed 17 April 2020]

210 Demos, *Free radicals* (April 2018): <https://demosuk.wpengine.com/wp-content/uploads/2018/04/Free-Radicals.pdf> [accessed 17 April 2020]

211 [Q 19](#) (Dr Iain Campbell, Independent Health Professionals Association)

212 Written evidence from Morson Group plc ([DFD0114](#))

213 Written submission from Stop the Off-payroll Tax Campaign ([DFD0143](#)). It is referred to here as a “hirers’ tax”.

214 Written evidence from Cornwallis Elt ([DFD0112](#))

215 Written evidence from British Chemical Engineering Contractors Association ([DFD0122](#))

216 [Q 14](#) (Julia Kermode, Freelance and Contractor Services Association)

(including employers' contributions) and the self-employed might offer a solution. For example, the OTS wrote:

“The final, broader, part of the economic issue here is for the Government to consider narrowing the difference in the tax/national insurance costs between self-employment and employment.”²¹⁷

162. In the past, the Government has said that it had no plans to change the structure of NICs.²¹⁸ But it seems that its position may be changing. On 26 March 2020, when announcing the financial support that the Government was offering to the self-employed in response to the COVID-19 pandemic,²¹⁹ the Chancellor of the Exchequer commented: “It is now much harder to justify the inconsistent contributions between people of different employment statuses.”²²⁰

A statutory employment test

163. There was support among witnesses for a statutory employment test that would give workers greater certainty.²²¹ As we demonstrated in chapter 2, many thought that the Government should pursue the proposals in this area that were made by the *Taylor Review of modern working practices*. But there was a perception that work on them had stalled.²²²
164. A statutory employment test could give individuals, employers and clients certainty, and address fairness in employment rights. Some witnesses felt that if *The Good Work Plan*²²³ (the Government's response to the Taylor Review) indicated the direction of travel, the off-payroll rules seemed inconsistent with it, because if a statutory employment test were introduced, it would replace the rules' status test.²²⁴ The Employment Lawyers' Association (ELA) suggested that there was a significant overlap of focus between the off-payroll rules and *The Good Work Plan*, and that it would be beneficial to consider them together.²²⁵

217 Written evidence from Office of Tax Simplification (OTS) ([DFD0104](#))

218 HM Revenue Customs, Off-payroll working in the private sector: summary of responses (29 October 2018) paragraph 2.32: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752160/Off-payroll_working_in_the_private_sector_-_summary_of_responses.pdf [accessed 17 April 2020]

219 The specific measures directed at the self-employed would not be applicable to workers employed by their own PSC. They would instead be eligible under other measures (for example, statutory sick pay or the job retention scheme). See written evidence from Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, HM Treasury ([DFD0156](#))

220 HM Treasury, speech, ‘Chancellor outlines new coronavirus support measures for the self-employed’ (26 March 2020): <https://www.gov.uk/government/speeches/chancellor-outlines-new-coronavirus-support-measures-for-the-self-employed> [accessed 17 April 2020]

221 For example, written evidence from Law Society of Scotland ([DFD0107](#)), Association of Professional Staffing Companies ([DFD0110](#)) and The HR Dept ([DFD0117](#)); also see [Q 11](#) (Colin Ben-Nathan, Chartered Institute of Taxation) and [Q 19](#) (Dr Iain Campbell, Independent Health Professionals Association)

222 Written evidence from Employment Lawyers' Association ([DFD0108](#)) and [Q 5](#) (Anita Monteith, Institute of Chartered Accountants of England and Wales)

223 HM Government, *Good Work: A response to the Taylor Review of modern working practices* (February 2018): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/679767/180206_BEIS_Good_Work_Report_Accessible_A4_.pdf [accessed 16 April 2020]

224 Written evidence from Cornwallis Elt ([DFD0112](#)), Association of Independent Professionals and the Self-Employed ([DFD0101](#)), Low Incomes Tax Reform Group ([DFD0100](#)) and Law Society of Scotland ([DFD0107](#))

225 Written evidence from Employment Lawyers' Association ([DFD0108](#))

Linking application of the rules to length of engagement

165. One feature of a statutory employment test could be the length of engagement by a client.²²⁶ If the contractor was working for a particular client for either a specific length of time, or for the vast majority of their time, they would be classified as employees. Such a proposal would effectively be a variation on a statutory employment test.²²⁷

Office of Tax Simplification

166. Since its study of IR35 in 2011, the OTS has not directly considered the rules again, although it has discussed issues relating to contractors and IR35 in a number of other papers and reports on the boundary between employment and self-employment.²²⁸ The OTS did not formally respond to the 2018 consultation on the extension of the off-payroll rules.²²⁹ We were nevertheless surprised to hear that HMRC did not involve the OTS in the recent review of the implementation of the new rules.²³⁰
167. However, the OTS did contribute to the 2016 consultation on the public sector changes. Its response argued:

“We think there is a need to keep this whole area of how the flexible workforce engages with the tax system under review”;

“We think a review focusing specifically on the taxation of the flexible workforce should be considered”; and

“There needs to be a project to try to develop a simpler test that can provide binding certainty, taking into account both tax and employment status.”²³¹

226 HM Revenue Customs, Off-payroll working in the public sector: reform of the intermediaries legislation (26 May 2016): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/526614/Off-payroll_working_public_sector-reform_intermediaries_legislation.pdf [accessed 17 April 2020]

227 Office of Tax Simplification, Employment status report (March 2015): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/537432/OTS_Employment_Status_report_March_2016_u.pdf [accessed 16 April 2020]

228 Office of Tax Simplification, Employment status report (March 2015): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/537432/OTS_Employment_Status_report_March_2016_u.pdf [accessed 16 April 2020]; Office of Tax Simplification, Small company taxation review, (2016): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/504850/small_company_taxation_review_final_03032016.pdf [accessed 17 April 2020]; Office of Tax Simplification, Lookthrough taxation (3 November 2016): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/564577/Lookthrough_paper_-_final.pdf [accessed 17 April 2020]; Office of Tax Simplification, The gig economy focus paper (22 June 2017): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/621174/20170620_OTG_Gig_economy_Focus_paper_update.pdf [accessed 17 April 2020]

229 HM Revenue and Customs, Off-payroll working in the private sector: summary of responses, (29 October 2018) p 20: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752160/Off-payroll_working_in_the_private_sector_-_summary_of_responses.pdf [accessed 17 April 2020]

230 Q 27 (Bill Dodwell, Office of Tax Simplification)

231 Office of Tax Simplification, Off-payroll working in the public sector consultation response (2 September 2016): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/549849/OTS_Off-payroll_working_in_the_Public_Sector_-_Consultation_Response.pdf [accessed 17 April 2020]

168. The comprehensive *Employment status report* published by the OTS in 2015 recognised the need to modernise the tax system to keep pace with change.²³² The report noted that the tax system was “still in many ways stuck in an out-of-date mindset of categorising workers as either employees, firmly in the payroll, or self-employed ... this made sense in the 1950s and 1960s but the huge growth in freelancing as a way of life (and work) doesn’t fit readily into this traditional model”. The OTS focused on three main issues: the tax and NICs differential between employees and the self-employed, employment rights, and the lack of certainty on the dividing line between employment and self-employment—which it felt invited attempts to “game” the rules.
169. The report discussed possible responses. These included creating a statutory employment test, aligning tax and NICs payments across the employed and self-employed, deduction of tax at source via a withholding tax (based on the Construction Industry Scheme) or a “third way”, creating a new status of worker, between employment and self-employment, with its own special rules. The OTS concluded: “The statutory employment test is an idea that needs to be taken forward” and noted that responses to its review had called for any new test to apply both to tax and employment rights.
170. The OTS considered two possible approaches for such a test:
- (1) A detailed test based on case law which would synthesise the principles and rules that have emerged from litigation in this area. The OTS acknowledged that any such test was bound to be complex.
 - (2) Alternatively, a simpler, pragmatic test based on applying up to five specific quantitative tests (including, for example, the proportion of time spent working for, or the proportion of income derived from, a particular organisation). To illustrate, the OTS suggested that a person who derived 80% of their income from a single client would be treated as an employee. Similarly, a person who spent more than X months working for an organisation would be treated as an employee—although one working fewer than X days or weeks for an organisation would not.²³³ In its evidence to this inquiry the OTS reaffirmed the value of a statutory employment test:

“Today, we would recommend that the Government should consult on introducing a statutory test. ... the end result would be one of simplification since both individuals and engagers would know whether or not the arrangements they were contemplating (or had entered into) amounted to employment or self-employment.”²³⁴
171. **We heard a number of proposals for alternatives to the off-payroll working rules. While these proposals would need to be developed in more detail, fully costed and rigorously tested, they could represent a less complex approach than the off-payroll rules, while giving contractors and clients certainty about their position.**

232 Office of Tax Simplification, *Employment status report* (March 2015): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/537432/OTS_Employment_Status_report_March_2016_u.pdf [accessed 16 April 2020]

233 Office of Tax Simplification, *Employment status report* (March 2015): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/537432/OTS_Employment_Status_report_March_2016_u.pdf [accessed 16 April 2020]

234 Written evidence from Office of Tax Simplification ([DFD0104](#)). See also [Q 26](#) (Bill Dodwell, Office of Tax Simplification)

172. **Several of the proposals would meet the Government's stated objectives for the off-payroll reforms: delivering fairness between employees and contractors working in similar situations, and bringing in tax revenue that is currently unpaid. However none is as comprehensive as the Taylor Review proposals, which we believe offer the best long-term solution, and which provide the opportunity to consider tax, rights and risk together.**
173. **We have argued that the main purpose of the off-payroll reforms is to raise revenue. In April 2021 the private sector is likely still to be recovering from the COVID-19 pandemic; the Government will therefore need to consider carefully the merits of various approaches to revenue-raising. Pending the outcome of further work on the Taylor Review, and the development and implementation of a comprehensive solution, we propose that the Government implement one of the simpler, less burdensome alternatives to the off-payroll rules that stakeholders have advanced.**

CHAPTER 6: GUIDING PRINCIPLES

174. Drawing on the evidence gathered in our inquiry we have considered what principles should apply in testing whether any new proposal, whether for a statutory employment test or a “stop-gap” solution, will meet the policy objectives of improving compliance, protecting the tax base and promoting fairness in the amount of tax paid by people doing similar jobs.
175. **We recommend that the Government design a short-term means of raising revenue that will not prove burdensome for businesses as they emerge from the COVID-19 pandemic, and a long-term alternative solution to the off-payroll working rules. In so doing, they should apply the following six principles.**
176. **Any alternative to the off-payroll working rules should be:**
- **Certain—the complexity of the off-payroll rules and the limitations of the CEST tool mean that it is difficult for clients and contractors to be certain about their position. All parties should have certainty about the tax treatment that will apply.**
 - **Simple—the off-payroll rules are too complicated. Any solution should be as simple as possible.**
 - **Fair—the proposed off-payroll rules are unfair because they treat contractors as employees for tax purposes only, essentially creating “zero-rights” employment. Treatment as an employee for tax purposes should only apply where there are employment rights and risk-sharing between employer and contractor.**
 - **Supportive of growth—any solution should respect and preserve the flexibility that exists within the UK labour market.**
 - **Administratively straightforward—the burden that the off-payroll rules imposes on clients is unreasonable. Any alternative needs to be straightforward to operate, and not excessively burdensome to administer.**
 - **Enforceable—with limited resources, IR35 became impractical for HMRC to monitor and enforce. Any new proposal should be manageable for HMRC.**

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

1. Our witnesses described how workers become self-employed for many different reasons. We agree with HMRC that the growth in the numbers of self-employed people and of PSCs is evidence of a significant shift in how the UK labour market operates. (Paragraph 14)
2. The growth of the gig economy in recent years has increased self-employment, particularly for lower-paid workers. It is regrettable that in some cases this has come at the expense of employment protections for workers. (Paragraph 15)
3. The tax system needs to adapt to these significant labour market changes. However the challenges posed by these changes go well beyond the tax system. Trying to address them from a tax perspective alone is unlikely to deliver the optimal solution (Paragraph 16)
4. Off-payroll rules build on a flawed system—IR35. They separate employment status for tax purposes from employment status under employment law. This distinction is unacceptable, not least because it fails to acknowledge that contractors bear all the risk for providing the workforce flexibility from which both parties benefit. (Paragraph 31)
5. We support IR35’s original policy aims of trying to ensure greater fairness in the tax system, and of preventing some contractors and client businesses gaining an unfair tax advantage. However, we are concerned that the rules have proved to be ineffective over a prolonged period and that, notwithstanding its reviews of IR35, the Government has not done more to tackle such problems, or to find a better alternative to these rules. Furthermore, with the emergence of the gig economy in the intervening years, the nature of employment has changed. This puts the issue of “fairness” in a new context. (Paragraph 44)
6. There was significant support from our witnesses for the recommendations in the Taylor Review—and significant disappointment that work on them seems to have stalled. (Paragraph 45)
7. It is concerning that the Government has pressed ahead with the off-payroll working rules at a time when the Taylor Review, which it commissioned, recommended a more holistic solution than these rules can offer. This is a solution with which the Government has said that it agrees, and on which it had launched a consultation. The lack of strategic co-ordination on this issue across Government and between Departments is highly regrettable. (Paragraph 46)
8. We recommend that the Government carry forward its work on the Taylor Review, to develop the review’s ideas into legislation which is responsive to the changing labour market and works across both tax and employment law.(Paragraph 47)
9. In some parts of the public sector (including the NHS) the off-payroll working rules were not applied properly. As a result of blanket assessments, contractors are likely to have been miscategorised and taxed incorrectly. Some contractors ceased working in the public sector altogether, causing recruitment and retention problems. (Paragraph 62)

10. It is regrettable that no proper evaluation has been carried out into the effect of the off-payroll working rules in the public sector. Such an evaluation should have preceded and informed any decision to extend the rules to the private sector. (Paragraph 63)
11. We are not convinced that the Government has learnt lessons from the application of IR35 in the public sector. If the Government continues with its plan to introduce the off-payroll reforms in April 2021, we recommend that the Government undertake an independent review of the implementation of the off-payroll rules in the public sector and an analysis of the impact of those rules on the labour market. (Paragraph 64)
12. Given that the off-payroll rules do not change the substance of the IR35 status determination requirement, we conclude that HMRC is imposing a heavy burden on businesses by requiring them to determine status using a complex, fact-specific test. We agree with our witnesses that the support offered by HMRC in determining status—and the CEST tool in particular—falls well short of what is required. (Paragraph 81)
13. The new rules make no changes to the IR35 test of employment status. In the light of the widely reported complexity of the case law test, this will leave businesses with significant challenges in determining the status of contractors. (Paragraph 86)
14. Large- and medium-sized businesses are being made responsible for enforcing a regime which HMRC has struggled with over the last 20 years. Effectively, therefore, the Government is privatising tax compliance. (Paragraph 87)
15. We question whether the CEST tool as currently constituted is fit for purpose. It offers limited assistance to businesses, which need to spend considerable time and money clarifying the status of their contractors as a result. We believe that the costs to businesses of implementing the changes have been severely underestimated and that HMRC has not fully understood the impact of these measures. We therefore welcome HMRC's commitment to review the methodology that it uses to model these costs. (Paragraph 88)
16. Since both clients and contractors have driven the increase in the use of personal service companies and benefited from the resulting tax treatment, it seems unfair that the contractor will effectively bear the brunt of the client's National Insurance Contributions in addition to their own, greater, employment taxes. (Paragraph 99)
17. We received clear evidence that the blanket status assessments made in the public sector following the IR35 reforms there were being replicated in the private sector in advance of the private sector rules being implemented. (Paragraph 100)
18. We also heard that some organisations, many of them large businesses, are already refusing to engage any freelance contractors—and are thereby side-stepping the new rules. (Paragraph 101)
19. We call on HMRC to engage more with business and tax professional bodies about the risks associated with engaging umbrella companies. (Paragraph 102)
20. While it is not possible to quantify the potential behavioural effects of the new rules, our evidence was remarkably consistent in suggesting that any

such behavioural consequences risk an adverse impact on the economy. We agree with this analysis, and urge the Government to carry out a full assessment of how its proposals will affect the decisions that businesses and contractors make. (Paragraph 103)

21. In the short term at least, it is likely that the off-payroll changes will cause disruption to the UK's labour market. We are therefore concerned that the outcomes of extending off-payroll working to the private sector seem to have been assessed primarily in terms of increasing compliance. The Government needs to consider the damage that may be done to the diversity and flexibility of the labour market. Any future review of the impact of the measures must take into account the wider impact of the changes on the UK's labour market and the broader economy. (Paragraph 115)
22. We agree with our witnesses that revenue-raising is the major driver of the proposed changes. According to HMRC's own forecasts, improved compliance could bring as much as £4.1 billion by 2024/25 to the Exchequer. The value of this potential tax take requires any measures to improve compliance to work effectively for contractors, clients and HMRC. (Paragraph 125)
23. HMRC has acknowledged the challenges that IR35 has faced in improving compliance. However, under the new rules IR35 itself will not change. Instead businesses will now have to shoulder the compliance challenge. We share the concerns of our witnesses that the rules put too great a burden on businesses. (Paragraph 128)
24. We expect compliance with the off-payroll working rules to improve when responsibility passes to large- and medium-sized businesses, and that the tax take will increase as a result. However, we are apprehensive that some contractors will wrongly be categorised as within the rules. (Paragraph 129)
25. It is unfair that contractors within the rules are treated as employees for tax purposes but do not qualify for employment rights, thus creating a class of "zero-rights employees". The Government is replacing one unfairness with another. (Paragraph 130)
26. Flexible working by contractors is a legitimate and important part of the UK labour market. However, contractors are in a different category to employees, and should therefore be treated differently. Unless the Government accepts this distinction, the off-payroll rules could eliminate by stealth contractor flexible working, or force contractors to use umbrella companies without adequate legislative protection. Both outcomes would be unacceptable. (Paragraph 131)
27. The Government's review of the private sector reforms came barely weeks before the rules' planned implementation, and had a very short timetable and narrow remit. There was limited scope for proper consideration of stakeholders' concerns about the new rules—and less scope for proposing material changes. (Paragraph 137)
28. HMRC's publication of updated guidance on the new rules is welcome, but it is regrettable that guidance on key aspects of the rules was published only six weeks before their expected commencement. (Paragraph 138)
29. While we welcome the Government's commitment to commissioning external research into the impact of the reforms, the proposal that this research be carried out six months after the rules' implementation does

not give enough time to measure the true impact of the reforms. HMRC should defer any such research until 18 months after the rules have been in operation. (Paragraph 139)

30. Towards the end of our inquiry the scale of the adverse economic effects of the COVID-19 pandemic became clearer, as well as the restrictions imposed by the Government in response and what they might mean for business. This is the greatest shock that the UK's economy has experienced since the Second World War. (Paragraph 142)
31. We welcome the Government's decision to postpone the start date for extending the off-payroll rules to the private sector to April 2021. A deferral is necessary, but business is likely to need considerably longer than a year to recover from the disruption caused by the COVID-19 pandemic. It is right not to impose unnecessary burdens on business at such a difficult time. (Paragraph 143)
32. A delay gives time for further consideration. The Government should commission an independent review of the introduction of the off-payroll rules in the public sector and undertake an analysis of how introducing off-payroll rules to the private sector will affect the labour market. In addition, the delay provides time to tackle the ongoing deficiencies of CEST and the status determination process, and to revisit the Government's assessment of the costs to business of the proposals, which our evidence shows were significantly underestimated. (Paragraph 144)
33. The extra time should also be used to consider alternatives to the off-payroll rules that are fairer and less risky, and which do not treat individuals as employees for tax purposes when they do not enjoy the rights of employees. Once completed, the Government should present Parliament with a clear strategy to address the issue of fairness in the tax system and foster a flexible workforce in which contractors play a vital role. (Paragraph 145)
34. To give certainty to business, the Government should announce by October 2020 whether it will indeed implement the off-payroll rules in April 2021, or whether any on-going impact to the economy resulting from the COVID-19 pandemic will require their implementation to be delayed further. (Paragraph 146)
35. -We do not believe that its resistance to alternative approaches has served the Government well. The more intractable and difficult the problem, the more the Government needs to be flexible and open to a range of ways of tackling it. Yet the Government continues to focus on the off-payroll proposals—which are substantially the same as the existing IR35 rules, with all their inherent problems—as the only solution. (Paragraph 151)
36. We heard a number of proposals for alternatives to the off-payroll working rules. While these proposals would need to be developed in more detail, fully costed and rigorously tested, they could represent a less complex approach than the off-payroll rules, while giving contractors and clients certainty about their position. (Paragraph 172)
37. Several of the proposals would meet the Government's stated objectives for the off-payroll reforms: delivering fairness between employees and contractors working in similar situations, and bringing in tax revenue that is currently unpaid. However none is as comprehensive as the Taylor Review proposals,

which we believe offer the best long-term solution, and which provide the opportunity to consider tax, rights and risk together. (Paragraph 173)

38. We have argued that the main purpose of the off-payroll reforms is to raise revenue. In April 2021 the private sector is likely still to be recovering from the COVID-19 pandemic; the Government will therefore need to consider carefully the merits of various approaches to revenue-raising. Pending the outcome of further work on the Taylor Review, and the development and implementation of a comprehensive solution, we propose that the Government implement one of the simpler, less burdensome alternatives to the off-payroll rules that stakeholders have advanced. (Paragraph 174)
39. We recommend that the Government design a short-term means of raising revenue that will not prove burdensome for businesses as they emerge from the COVID-19 pandemic, and a long-term alternative solution to the off-payroll working rules. In so doing, they should apply the following six principles. (Paragraph 176)
40. Any alternative to the off-payroll working rules should be:
 - Certain—the complexity of the off-payroll rules and the limitations of the CEST tool mean that it is difficult for clients and contractors to be certain about their position. All parties should have certainty about the tax treatment that will apply.
 - Simple—the off-payroll rules are too complicated. Any solution should be as simple as possible.
 - Fair—the proposed off-payroll rules are unfair because they treat contractors as employees for tax purposes only, essentially creating “zero-rights” employment. Treatment as an employee for tax purposes should only apply where there are employment rights and risk-sharing between employer and contractor.
 - Supportive of growth—any solution should respect and preserve the flexibility that exists within the UK labour market.
 - Administratively straightforward—the burden that the off-payroll rules imposes on clients is unreasonable. Any alternative needs to be straightforward to operate, and not excessively burdensome to administer.
 - Enforceable—with limited resources IR35 became impractical for HMRC to monitor and enforce. Any new proposal should be manageable for HMRC. (Paragraph 177)

APPENDIX 1: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

Members of the Finance Bill Sub-Committee

Baroness Bowles of Berkhamsted
Lord Bridges of Headley
Lord Desai
Lord Forsyth of Drumlean (Chair)
Baroness Kramer
Lord Monks
Lord Rowe-Beddoe
Lord Tyrie

Declarations of interests

Baroness Bowles of Berkhamsted
No relevant interests

Lord Bridges of Headley
Adviser to Banco Santander, Madrid, Spain

Lord Desai
No relevant interests

Lord Forsyth of Drumlean (Chair)
No relevant interests

Baroness Kramer
No relevant interests

Lord Monks
No relevant interests

Lord Rowe-Beddoe
No relevant interests

Lord Tyrie
Chairman of the Competition and Markets Authority (June 2018 to present)
Chairman of the Jersey Financial Stability (Shadow) Board

Members of the Economic Affairs Committee

The Economic Affairs Committee agreed this report by correspondence

Baroness Bowles of Berkhamsted
No relevant interests

Lord Burns
No relevant interests

Viscount Chandos
No relevant interests

Lord Cunningham of Felling
No relevant interests

Lord Forsyth of Drumlean (Chair)
No relevant interests

Lord Fox
Sole director of Vulpes Advisory Limited

Baroness Harding of Winscombe
No relevant interests

Baroness Kingsmill

No relevant interests
Lord Livingston of Parkhead

No relevant interests
Lord Monks

No relevant interests
Lord Skidelsky

No relevant interests
Lord Stern of Brentford

No relevant interests
Lord Tugendhat

No relevant interests

A full list of members' interests can be found in the Register of Lords' Interests:
<https://www.parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-lords-interests/>

Specialist Advisers

Robina Dyall
No relevant interests

Sarah Squires
Member of the Tax Law Committee of the Law Society of England and Wales

APPENDIX 2: LIST OF WITNESSES

Evidence is published online at: <https://committees.parliament.uk/committee/230/finance-bill-subcommittee/publications/> and available for inspection at the Parliamentary Archives (020 7219 3074)

Evidence received by the Sub-Committee is listed below in chronological order of oral evidence session and in alphabetical order. Those marked with ** gave both oral 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

**	Jason Piper, Head of Tax and Business Law— Professional Insights, Association of Chartered Certified Accountants (ACCA)	QQ 1–6
**	Justine Riccomini, Head of Taxation (Scottish Taxes, Employment and ICAS Tax Community), Institute of Chartered Accountants of Scotland (ICAS)	QQ 1–6
**	Anita Monteith, Tax Technical Lead and Senior Policy Adviser, Institute of Chartered Accountants in England Wales (ICEAW)	QQ 1–6
**	Colin Ben-Nathan, Chair, Employment Taxes Committee at Chartered Institute of Taxation (CIOT)	QQ 7–12
**	Meredith McCammond, Technical Officer for LITRG and Chartered Tax Adviser, Low Incomes Tax Reform Group (LITRG)	QQ 7–12
**	Andrew Chamberlain, Tax Policy at Association of Independent Professionals and the Self-Employed (IPSE)	QQ 13–18
**	Abigail Agopain, Principal Tax Adviser at Confederation of British Industry (CBI)	QQ 13–18
**	Lorence Nye, Federation of Small Business (FSB)	QQ 13–18
**	Julia Kermode, Chief Executive, Freelancer and Contractor Services Association (FCSA)	QQ 13–18
**	Dr Iain Campbell, Secretary-General, Independent Health Professionals Association (IHPA)	QQ 19–25
*	John McVay OBE, Chief Executive at Producers Alliance for Cinema and Television (PACT)	QQ 19–25
**	Matthew Abraham, Supply Chain Director at Oil and Gas UK (OGUK)	QQ 19–25
**	Bill Dodwell, Tax Director, Office of Tax Simplification (OTS)	QQ 26–32
**	Karen Thomson, Board Member, Administrative Burdens Advisory Board (ABAB)	QQ 26–32
**	Stephen Ratcliffe, Member of Legislative and Policy Committee, Employment Lawyers' Association (ELA)	QQ 33–40

- ** Keith Gordon, Temple Tax Chambers [QQ 33-40](#)
- ** Caroline Colliston, Member of Tax Law and Policy sub-committee, Law Society of Scotland [QQ 33-40](#)
- ** Professor Patricia Leighton, Centre for Research on Self-Employment [QQ 41-51](#)
- * Siobhan Endean, National Officer for Equalities, Unite the Union [QQ 41-51](#)
- ** Cerys McDonald, Director, Off-Payroll Reform Programme, HM Revenue and Customs (HMRC) [QQ 52-57](#)
- ** Paul Riley, Director, Tax Administration, HM Revenue and Customs (HMRC) [QQ 52-57](#)
- ** Lindsey Whyte, Director, Personal Tax, Welfare and Pensions, HM Treasury (HMT) [QQ 52-57](#)
- ** Carl Vincent, Chief Financial Officer, NHS Digital [QQ 58-62](#)

Alphabetical list of witnesses

**	Matthew Abraham, Supply Chain Director, Oil and Gas UK (OGUK) (QQ 19–185)	<u>DFD0105</u>
	Abigail Agopian, Principal Tax Adviser, Confederation of British Industry (CBI) (QQ 13–25)	
**	Andrew Chamberlain, Tax Policy, Association of Independent Professionals and the Self-Employed (IPSE) (QQ 13–18)	<u>DFD0101</u>
	Association of Professional Staffing Companies (APSCo)	<u>DFD0110</u>
	Association of Recruitment Consultancies (ARC)	<u>DFD0139</u>
	Association of Tax Technicians (ATT)	<u>DFD0109</u>
*	Colin Ben-Nathan, Chair, Employment Taxes Committee at Chartered Institute of Taxation (CIOT) (QQ 7–12)	<u>DFD0122</u>
	British Chemical Engineering Contractors Association (BCECA)	<u>DFD0122</u>
**	Dr Iain Campbell, Secretary General, Independent Health Professionals Association (IHPA) (QQ 19–25)	<u>DFD0103</u>
	Carrington Accountancy	<u>DFD0148</u>
	Chartered Institute of Payroll Professionals (CIPP)	<u>DFD0141</u>
	Caroline Colliston, Member of Tax Law and Policy sub-committee, Law Society of Scotland	<u>DFD0107</u>
	Company Chemists Association	<u>DFD0142</u>
	Competex	<u>DFD0147</u>
	ContractorCalculator	<u>DFD0146</u>
	Cornwallis ELT	<u>DFD0112</u>
	Deloitte	<u>DFD0120</u>
**	Bill Dodwell, Tax Director, Officer of Tax Simplification (OTS) (QQ 26–32)	<u>DFD0104</u>
*	Siobhan Endean, National Officer for Equalities, Unite the Union (QQ 41–51)	
	Employment Taxes Industry Forum	<u>DFD0121</u>
	Federation of Small Business (FSB)	<u>DFD0106</u>
**	Keith Gordon, Temple Tax Chambers (QQ 33–40)	<u>DFD0092</u>
	Hays Recruitment Consultancies	<u>DFD0136</u>
	Hydrogen Group	<u>DFD0119</u>
	InniAccounts	<u>DFD0118</u>
	Institute of Employment Rights (IER)	<u>DFD0140</u>

**	Julia Kermodé, Chief Executive, Freelancer and Contractor Services Association (FCSA) (QQ 13–18)	DFD0102
	Law Society of England and Wales	DFD0138
**	Professor Patricia Leighton, Centre for Research on Self-Employment (QQ 41–51)	DFD0111
**	Meredith McCammond, Technical Officer for LITRG and Chartered Tax Adviser, Low Incomes Tax Reform Group (LITRG) (QQ 7–12)	DFD0100
**	Cerys McDonald, Director, Off-Payroll, Reform Programme, HM Revenue and Customs (HMRC) (QQ 52–57)	DFD0153 DFD0154
*	John McVay OBE, Chief Executive, Producers Alliance for Cinema and Television (PACT) (QQ 19–25)	
**	Anita Monteith, Tax Technical Lead and Senior Policy Adviser, Institute of Chartered Accountants of England and Wales (ICAEW) (QQ 1–6)	DFD0097
	Morson Group plc	DFD0114
	Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, HM Treasury (HMT)	DFD0156
**	Lorence Nye, Senior Policy Adviser, Federation of Small Business (FSB) (QQ 13-18)	DFD0106
**	Jason Piper, Head of Tax and Business Law - Professional Insights, Association of Chartered Certified Accountants (ACCA) (QQ 1–6)	DFD0098
	Prism Association	DFD0149
**	Stephen Ratcliffe, Member of Legislative and Policy Committee, Employment Lawyers' Association (ELA) (QQ 33–40)	DFD0108
	Recruitment & Employment Confederation	DFD0123
**	Justine Riccomini, Head of Taxation (Scottish Taxes, Employment & ICAS Tax Community), Institute of Chartered Accountants of Scotland (ICAS) (QQ 1–6)	DFD0099
*	Paul Riley, Director, Tax Administration, HM Revenue and Customs (HMRC) (QQ 52–57)	
	Rullian Ltd	DFD0137
	Self-Employed Australia (SEA)	DFD0151
	Smith & Williamson LLP	DFD0144
	SThree	DFD0116
	StopIR35 campaign	DFD0096
	Stop the Off-Payroll Tax Campaign	DFD0143
	SystemsAccountants	DFD0145

	The TaxAssist Group	<u>DFD0113</u>
	The HR Dept	<u>DFD0117</u>
	Third Stage Consulting Group	<u>DFD0150</u>
*	Karen Thomson, Board Member, Administrative Burdens, Advisory Board (QQ 26–32)	
**	Carl Vincent, Chief Financial Officer, NHS Digital (QQ 58–62)	<u>DFD0115</u>
**	Lindsey Whyte, Director Personal Tax, Welfare and Pensions, HM Treasury (HMT) (QQ 52–57)	<u>DFD0154</u>

Collated written evidence submitted by individuals may be viewed at: <https://committees.parliament.uk/download/file?url=%2Fpublications%2F766%2Fdocuments%2F4589&slug=fbsc-evidence-volume-individualspdf>

APPENDIX 3: CALL FOR EVIDENCE

The Finance Bill Sub-Committee, chaired by Lord Forsyth of Drumlean, is appointed annually by the Economic Affairs Committee to consider the draft Finance Bill. The Sub-Committee focuses on issues of tax administration, clarification and simplification rather than on rates or incidence of tax.

The draft Finance Bill was published on 9 July 2019, in order that final measures could be confirmed at the time of the expected autumn 2019 Budget, which was then postponed. The Finance Bill is now due to be published shortly after this year's Budget, on 11 March 2020.

The Government recently confirmed that the Finance Bill will include provisions to extend the off-payroll working rules to large and medium-sized businesses in the private sector. The Sub-Committee is inquiring into these proposed provisions.

Under the provisions, organisations which engage a sub-contractor will be required to determine the employment status of that sub-contractor for tax purposes, deduct tax and National Insurance Contributions (NICs) from payments to any sub-contractors deemed to be employees, and pay employers' NICs.

The Sub-Committee invites interested individuals and organisations to submit written evidence to this inquiry.

Areas of interest

The Sub-Committee welcomes views on any of the following questions relating to the proposed extension of the off-payroll working rules to the private sector. The Sub-Committee is interested to know about the real-life experiences of individuals and organisations, as well as more general responses—for example, relating to the impact of these (and predecessor) measures on the tax classification of workers and the broader impact on the labour market.

Existing measures in the public sector

1. What has been the experience of the new off-payroll rules in the public sector? What lessons have been learned from this experience, and how have they affected the draft Finance Bill proposals?

Impact of new off-payroll rules on organisations

2. Has the impact of the extension of the off-payroll rules to the private sector been adequately assessed? In particular, is the assessment that has been made of the compliance burden (including costs) of these new rules realistic? Has the right balance been struck in the compliance burden on the taxpayer and on HMRC?
3. Is the exclusion of small organisations sufficiently robust, and how might small organisations gain sufficient assurances that they fall within the exclusion?
4. What will be the effect of these new measures on a chain of contractors and subcontractors?
5. What scope might there be for simplifying or otherwise reducing the administrative burden of these measures? What should HMRC do to help businesses understand the new administrative rules?

Determining tax status of workers

6. Are the tests for determining employment for the purposes of these rules sufficiently clear to both engager and worker? Do they reflect the reality of the contracting environment?
7. What is your assessment of the Check Employment Status for Tax (CEST) tool? Does it require improvement? If so, how might it be improved?
8. How effective will the status determination process be in resolving issues of employment status? Are there adequate safeguards, allowing decisions to be challenged? If not, what more is needed?

Policy objectives and wider context

9. Are there better or simpler ways in which the objective of the new rules might be achieved? If so, what are they?
10. Will the Bill, as drafted, achieve the Government's objectives?
11. What is your view of the role of umbrella companies in the context of these proposals?
12. How do the new measures relate to the wider context of changes in working arrangements, including the 'gig economy'? Is it fair that some individuals are taxed as if they are employees, but do not have the rights of employees?

APPENDIX 4: SUMMARY OF WRITTEN EVIDENCE

1. We received over 700 responses to our call for written evidence.²³⁵ We are very grateful to those who took the time to inform our inquiry. The following are illustrative examples taken from those submissions, organised according to the broad themes of our report.

Existing measures in the public sector

2. We heard that the introduction of off-payroll legislation in the public sector was not as successful as HMRC had suggested. Submissions stated that a number of public sector bodies made blanket status determinations; this was particularly true within NHS and public sector IT projects, which resulted in many skilled professionals leaving the sector.

*Steven Harrison—owner of a small business that contracts ICT services*²³⁶

“While some hiring managers [in the public sector] are able to correctly navigate their way through the status determination statement (SDS) process, it’s clear that they only do so when they are unable to progress their project by any other means ... there are still a disproportionate number of roles which are deemed inside when they are in fact project-based roles which should be deemed outside. I think at the heart of the problem is that the rules to determine a particular role’s status are too complex and too open to interpretation.”

*Jane Johnson—independent consultant for public sector*²³⁷

3. “Having already been deemed ‘IR35’ in 2017 by virtue of a blanket assessment ... I have first-hand experience of seeing many Personal Service Companies forced to make life-changing decisions about how they offered their services to their clients, often with no option but to close down their small businesses. Not only that, but the knock-on effect was that many of the big consultancies were able to ‘clean up’ in terms of picking up all the public sector project work that was likely to fail without the support of independent contractors.”

*Amritpal Gill—owner of an IT Consultancy (Hayachi Services LTD)*²³⁸

4. Mr Gill ceased to work within the public sector when the IR35 reforms were implemented there, because his company was subject to “blanket assessments in regards to off-payroll”. He stated that public sector organisations were not “considerate of the individual circumstances of businesses they contract”.

“In effect, it meant a total submission of control and a rate cut to boot ... and concern over future assessments or investigations meant we would rather not risk [working for public sector organisations].”

235 Our collated written evidence from individuals can be viewed here: <https://committees.parliament.uk/download/file/?url=%2Fpublications%2F766%2Fdocuments%2F4589&slug=fbsc-evidence-volume-individualspdf>

236 Written evidence from Mr Steven Harrison ([collated written evidence from individuals](#))

237 Written evidence from Mr Jane Johnson ([collated written evidence from individuals](#))

238 Written evidence from Mr Amritpal Gill ([collated written evidence from individuals](#))

*Andy Ong—IT consultant*²³⁹

5. Prior to the implementation of the IR35 rules in the public sector, Mr Ong had been working on a large public sector project.

“Every contractor that came through the door was highly skilled in their field, and for those that weren’t up to standard they were let go at a week or two’s notice. This helped keep the project appropriately resourced with the ability to rapidly scale up and down as required. There were no complaints or tribunals when we were let go in swathes as this is part of the risk we accept living the life of a contractor, in that we forego our employment rights/benefits, such as holiday pay, sick pay, paid maternity/paternity leave, pension, bonus, company healthcare schemes, right to strike, right to training/professional development, unfair dismissal, etc. for the single purpose of being able to take home more money while we are in contract (of which we often spend months out of contract depending on market conditions with no income or help) ... when I finished this contract in 2016, and knowing about the public sector IR35 shake up, I immediately discounted any public sector inside IR35 contracts as at the time the rates were comparable to private however there would be a significant take home reduction. I was essentially unemployed for three months before I found my next private contract and have never even considered other public sector contracts.”

Impact of new off-payroll rules on contractors

6. Contractors told us that since the announcement of the new off-payroll working rules, many private sector companies had made blanket determinations, and some large companies had decided not to engage contractors at all. Numerous submissions outlined the financial implications of blanket determinations, such as clients passing employer NIC burdens to workers (thereby reducing pay). They said that this had forced some companies to close due to loss in earnings.

*Christopher Lopez-Smith—self-employed civil engineer*²⁴⁰

“I am currently providing my services to a private organisation and I have been given notice that my contract will be terminated on 31 March 2020. This is because the organisation has agreed on a blanket corporate decision to not use contractors with a Limited Company after the new rules are introduced in April 2020.”

*David Cooper—contractor in the construction industry*²⁴¹

7. Mr Cooper’s company provides engineering and surveying services to the construction industry. His clients expect him to provide his own equipment. His current client decided that every contractor on-site was within IR35.

“(IR35) causes companies like mine a massive problem. What does the company do with the assets? My company has invested in thousands of pounds’ worth of specialist equipment ... employees (in my industry) aren’t expected to provide their own tools, or specialist equipment or insurance. They are provided with a computer and a phone and are told

239 Written evidence from Mr Andy Ong ([collated written evidence from individuals](#))

240 Written evidence from Mr Christopher Lopez-Smith ([collated written evidence from individuals](#))

241 Written evidence from Mr David Cooper ([collated written evidence from individuals](#))

what to do ... the firms I work for know that my company will provide everything required to get the task done.”

*Amelia Berriman—freelance business consultant*²⁴²

8. Ms Berriman left her previous contract to avoid a blanket assessment in anticipation of the IR35 reforms. Ms Berriman explained in her submission that the proposed reforms meant that she was unlikely to continue to work as a freelancer. The loss of income made her “high-pressure” consultancy work, which “carries sufficient reputational risk”, a less attractive option.

“I would most likely revert to paid employment, early retirement or a career change rather than be taxed like an employee with no rights in highly stressful, long hours working assignments.”

*Ben Knibbs—freelance design engineer*²⁴³

9. Mr Knibbs stated that the IR35 changes had already led most of his clients to take “the no-risk option” and declare “contract workers to be inside IR35 rules”.

“I don’t mind having to pay fairly more tax ... however ... the client will deduct employers’ NI from my rate ... they get around your rules by offering me a new lower rate and a new contract. So although I am deemed an employee I have to pay the employers’ NIC myself. That alone is unfair and wrong in my opinion, resulting in an abrupt drop in my earnings.”

Role of umbrella companies

10. Many witnesses thought that the reforms would lead to an increase in the use of umbrella companies, as happened in the public sector. It was generally felt that umbrella companies could encourage avoidance by businesses that outsource responsibility, with some umbrella companies continuing to use disguised remuneration schemes.

*Philip Beardwood—director of a recruitment business*²⁴⁴

11. Mr Beardwood wrote to us on behalf of the Morson Group (a recruitment business which engages contractors in the public and private sectors), of which he is a director. He stated that the company had seen many of its previous clients in the public sector made subject to “blanket inside assessments” as a result of IR35, and pushed towards umbrella companies.

“The practice of blanket assessments has impacted lower-paid contractors who were encouraged to switch to umbrella companies. Subsequently, many contractors ended up using non-compliant umbrella companies with promises of upward of 90% take home pay. These contractors are now being pursued by HMRC because of loan scheme debts, causing further concerns throughout the supply chain.”

242 Written evidence from Ms Amelia Berriman ([collated written evidence from individuals](#))

243 Written evidence from Mr Ben Knibbs ([collated written evidence from individuals](#))

244 Written submission from Mr Philip Beardwood ([collated written evidence from individuals](#))

*Colin George—freelance IT contractor*²⁴⁵

12. Mr George has worked as a freelance contractor in the private sector for over 22 years. He wrote that some of his contracts had “lasted two months, some ... two or three years”. Mr George has never received holiday or sick pay but values the “freedom, flexibility and autonomy” of contracting. However, the organisation with which he currently has a contract told him that it was adopting a “‘no-risk’ approach” and was informing all contractors that they were “being considered as ‘inside IR35’” unless they work through an umbrella company.

“I was recently informed that my current contract cannot run past the end of February 2020. It seems that if I wish to continue providing services to the credit insurance company from March onwards then I would have to operate via an umbrella company, forcing me to become an employee with no employee rights—the worst of both worlds. I would be an employee of the umbrella company, and yet all employer and employee NI, PAYE, etc., would be deducted from the fees that I earn—how can that be fair?”

*Ahmed Khan—IT contractor*²⁴⁶

13. Mr Khan wrote that his current client “as with many others” did not “want to go [into] the detailed process of assessment; it’s too costly for them so they have just taken a blanket approach where everyone is assessed to be inside IR35”. He warned that umbrella companies might take advantage of this situation.

“I have been approached by many umbrella companies who are promising take-home pay of up to 80% of the contract value; these are unregulated and are operating outside the rules. If some contractors use these companies then I think it’s again loss of tax for HMRC and will open the contractor for future tax investigations.”

The Check Employment Status for Tax (CEST) tool

14. It was generally considered that the CEST tool was not effective in making accurate determinations of IR35 status, including in its newer version. Another common concern was that the CEST tool did not consider mutuality of obligation, despite its importance in employment law in determining whether a contract of service exists.

*David Kirk—accountant*²⁴⁷

15. Mr Kirk, a chartered accountant and tax advisor, wrote to us about the 15% of cases where CEST was unable to give a determination.

“First of all, since the upgrade to the tool was made late last year this figure has actually gone up, to 20% (see <https://www.gov.uk/government/publications/check-employment-status-for-tax-cest-2019-enhancement/check-employment-status-for-tax-cest-2019-enhancement-summary>, table at paragraph 3.10). We do not currently know the reasons for this. Also, it is my understanding that if you call the HMRC helpline after receiving one of these replies they will no longer give you a status

245 Written submission from Mr Colin George ([collated written evidence from individuals](#))

246 Written submission from Mr Ahmed Khan ([collated written evidence from individuals](#))

247 Written submission from Mr David Kirk ([collated written evidence from individuals](#))

determination—they will only advise you on how to fill in the tool. In my submission HMRC need to be more engaged in the process than that.”

*Lianne Bowie—business consultant*²⁴⁸

16. Ms Bowie felt that the CEST tool was unable to determine her tax status, and stated that the CEST questions “did not reflect the reality” of her contracting environment.

“One of the tool[']s questions on costs asks: ‘*will you have to fund any other costs before your client pays you?*’ The reality is that I may need to travel to different locations and pay ‘non-commuting’ costs. If I need to, I pay the expenses then invoice the client. The outcome for me, as long as I’ve answered NO to all of the preceding questions, is: if I answer YES to this question, the tool determines that I’m outside of IR35. If I answer NO the tool says it is unable to make a determination... another question on financial risk [asks]: *If the client was not happy with your work would you have to put it right?* A lot of what I do is iterative so getting the client to be “happy” with my work can take repeated efforts. If I answered ‘yes, unpaid and you would have extra costs that your client would not pay for’ then I’m deemed outside IR35. The other four responses give an ‘unable to determine status’. None of the responses relate accurately to what the situation might be and the tool [cannot] tell me if I’m inside or outside IR35.”

*Matthew Searle—-independent IT professional*²⁴⁹

17. Mr Searle stated that CEST was “unfit for purpose as it does not reflect case law [and] puts an undue weighting on certain criteria, while ignoring the question of mutuality of obligation”.

“Determinations carried out using CEST have also been defeated at tribunal. In *RALC Consulting v HMRC* [2019] UKFTT 703 (TC), HMRC pushed to dismiss a determination from CEST as being included as evidence, arguing “The form, content and application of CEST to the appellant’s arrangements is irrelevant to the issues to be determined by the tribunal”. Third-party tools from providers such as Qdos Contractor, IR35 Shield and Kingsbridge Insurance have a higher reputation in the marketplace and have been proven to give more reliable results because they rely on case law.”

Fairness of the proposed changes

18. Most witnesses felt that the new off-payroll rules were inherently unfair as they sought to identify certain individuals as employed for tax purposes, without providing the benefits and protections that come with employment. Several submissions also stated that the new rules did not reflect the reality of modern working relationships and recommended that the Government introduce a statutory definition of self-employment before implementing the reforms.

248 Written submission from Ms Lianne Bowie ([collated written evidence from individuals](#))

249 Written submission from Mr Matthew Searle ([collated written evidence from individuals](#))

*Philip Beardwood—director of a recruitment business*²⁵⁰

19. Mr Beardwood wrote that a definition of self-employment should have been put in place before implementation of the off-payroll reforms.

“This would have facilitated easier status determination and provide greater distinction between highly skilled independent contractors and more vulnerable parts of the workforce who are likely to fall within the scope of IR35.”

*Steven Harrison—owner of a small business that contracts ICT services*²⁵¹

20. Mr Harrison wrote to us about the interwoven nature of “increased worker flexibility” and “treatment for taxation”.

“In the gig economy it may be true that a worker chooses to increase their flexibility in exchange for sacrificing some benefits. This freedom to exercise choice cannot and should not be ignored. The challenge therefore is ensuring that this freedom of choice does not unfairly disadvantage any group ... the key is that the worker must have the right to choose their treatment. If the system is crafted in such a way that a worker’s rights are infringed or restricted in some way without recourse (as has been done with the current IR35 implementation) then this is what must be avoided.”

COVID-19 and IR35

21. With the outbreak of COVID-19, several contractors were concerned about the combined effect of the virus and the off-payroll reforms on their ability to find work in the coming months.

*Tim Orme—contractor providing training consultancy services*²⁵²

“The coronavirus crisis has resulted in the postponement of 80% of my existing contract work for April to June ... until September onwards. My remaining contract work is with a client who is blanket-banning contractors due to IR35 as mentioned above. So, I either have to accept forced employment with an agency/umbrella with reduced rates and no employment rights—or I will have virtually no work for 6 months.”

*Iain Clark—contractor in financial services sector*²⁵³

22. Mr Clark wrote that due to a lack of alternative options resulting from “what was effectively the implementation of IR35 rules by some businesses at the end of February”, he had accepted a contract working within IR35. Following the outbreak of COVID-19, he was informed by the client that the contract was being terminated due to the virus.

“You could say that this would have happened irrespective of the IR35 legislation and, yes it could have. However, the contractors that have stayed with the client I was providing services to previously are all currently carrying on providing services [outside of IR35], so I believe that the fact that I am now out of contract is purely down to IR35. I also have no idea as to what my ‘status’ is and therefore what my rights

250 Written submission from Mr Philip Beardwood ([collated written evidence from individuals](#))

251 Written evidence from Mr Steven Harrison ([collated written evidence from individuals](#))

252 Written evidence from Mr Tim Orme ([collated written evidence from individuals](#))

253 Written evidence from Mr Iain Clark ([collated written evidence from individuals](#))

are. I was ‘employed for tax purposes’ when I accepted an inside IR35 contract, so am I now unemployed with rights to benefits or do I qualify for other measures as I was self-employed until the end of February and ‘employed with no employment rights’ after that period? Time will tell but with projects being postponed [and] cancelled my expectation is that I will simply have to ride out the coronavirus storm and hope that contracts become available as the country looks to recover physically and economically from its impacts.”

23. On the Government’s 12-month postponement of the IR35 reforms, he stated:

“For me this is too little, too late. My previous client couldn’t change anything in February when the first of HMRC’s late changes were announced. What makes HMRC [and] HM Government believe that business can reverse all of the changes they have been making with less than three weeks’ notice?”