

# Economic Affairs Committee

## Finance Bill Sub-Committee

### Corrected oral evidence: Off-payroll working— follow-up

Monday 6 December 2021

4.10 pm

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Members present: Lord Bridges of Headley (The Chair); Lord Butler of Brockwell; Baroness Harding of Winscombe; Baroness Kramer; Baroness Noakes.

Evidence Session No. 1

Heard in Public

Questions 1 - 15

#### Witnesses

**I:** Andrew Chamberlain, Director of Policy, Association of Independent Professionals and the Self-Employed (IPSE); Phil Pluck, Chief Executive, Freelancer and Contractor Services Association (FCSA); Martin McTague, Policy and Advocacy Vice-Chair, Federation of Small Businesses (FSB).

#### Examination of witnesses

Andrew Chamberlain, Phil Pluck and Martin McTague.

**Q1 The Chair:** Good afternoon and welcome to this meeting of the Finance Bill Sub-Committee. Could you introduce yourselves, please?

**Phil Pluck:** Good afternoon. I am the chief executive of the Freelancer and Contractor Services Association, hereafter referred to as the FCSA.

**Andrew Chamberlain:** Good afternoon, I am the director of policy at the Association of Independent Professionals and the Self-Employed, hereafter referred to as IPSE.

**Martin McTague:** I am the chair of policy and advocacy at the Federation of Small Businesses.

**Q2 The Chair:** Thanks very much indeed to each of you for coming in this afternoon. I will kick off with the first question and then pass on to my colleagues. We have heard a number of figures being bandied around about the number of people—and I stress the word people—who are affected by the changes in off-payroll working rules. HMRC has said that

180,000 personal services companies will be directly affected and 60,000 will not. There are different numbers, obviously, for the number who have come into umbrella companies, and there are a million or so uses of the CEST tool. I do not want to get into all the details on CEST right now. My simple question, first to Phil Pluck, and then Andy Chamberlain and Martin McTague can give us their views, is how many people you think are affected.

**Phil Pluck:** You posed the written question as 180,000 companies being directly affected and another 60,000 that will not. It is fair to say that all the personal service companies have been affected. Personal service companies, of course, are all individuals. Up to two years ago, the FCSA had 60,000 individuals running their limited companies through our member companies. We are now down to 41,000, but even that 41,000 are still affected by the off-payroll reforms, so I am not sure that the estimate of 180,000 given is not a bit too small. These are such far-reaching consequences for PSCs that I think that all those numbers, if not more, have been affected.

**Andrew Chamberlain:** I agree. Instinctively, I think that the 180,000 figure given by HMRC is a bit on the small side, but it is very difficult to get accurate figures on this. You have the problem of defining what a PSC is. There is no legal definition of it; it is just a limited company like any other. We know what we mean when we talk about them, but they are difficult to define and therefore difficult to identify and therefore difficult to count. HMRC's figures, I think it confesses itself, are an approximation. It uses some proxy indicators to get to those, so it is not completely sure either.

Last year, the ONS said that there were 715,000 sole directors of a limited company. Not all of those would meet the description, that we know of, of a personal service company, but we know that quite a few of them will do. In 2015, Oxford Economics did a piece of work for IPSE and assessed that 307,000 personal service companies were operating in the UK. That was six years ago. Since then, we know that there has been a big increase in the number of incorporations, because the OBR talked about that quite a lot. It is one reason why these rules started to come in. That is a long-winded way of saying that when you look at all the available figures, 180,000 sounds a bit small, but we do not have a definitive figure ourselves.

**Martin McTague:** I cannot add much to those two answers. I know that during the campaigns that were launched by companies trying to get Covid support—sole directors running personal service companies—certainly a lot more businesses seemed to fall into that category, and I think the number is closer to 400,000 than the 240,000 that are estimated.

**The Chair:** Is it fair to say that no one would disagree with the statement that 180,000 feels like an underestimate of some kind, but we are not sure how much?

**Andrew Chamberlain:** It is very light, yes.

**The Chair:** It is very light. Very good. We might come back to that in a moment.

Q3 **Baroness Harding of Winscombe:** What has your members' experience of the operation of the off-payroll working rules been in the first eight months?

**Phil Pluck:** There has been a shift in dynamics for my members. My members operate in three clear areas: services to PSCs, to limited companies; services to contractors who operate in the construction industry scheme; and umbrella. The first eight months also reflect the four or five months before April. There was a massive decrease. The numbers of PSC workers almost fell off a cliff at one point and we are now down to 41,500 or thereabouts.

There was also a resulting increase, of around 22,000, in the number of umbrella workers. For us, that is now up to about 174,000, or something like that, which our member companies represent. I know it is not part of this sub-committee, but the construction industry, bar a couple of weeks, remained incredibly resilient during the pandemic, so those figures tended to stay fairly robust, but the real shift was PSCs into umbrella workers.

In addition, a number of my member companies saw an exit of PSCs and individual limited company directors. Some of them decided that they no longer wanted to be involved in a PSC or a limited company and exited the market. That was a loss of some extremely high skills. There was a very noticeable shift in highly skilled European contractors. This is partly due to IR35, partly due to Covid and partly due to EU changes. They moved back to the EU mainland. Some of them were clearly able to operate from their homeland in central Europe, and they carried on working for UK companies but were out of the tax regime.

The other shift that our members have observed is a movement from some larger-end hirers, particularly in financial services, who have moved a lot of their back office and contract-to-project schemes out of the UK tax jurisdiction. We have seen some financial services move their operations to Dublin and others to central Europe. There has been a very noticeable shift in numbers and in the way businesses are operating with our members.

**Andrew Chamberlain:** I agree with everything that Phil has just said. We have seen evidence and heard stories along very similar lines. To answer the question about our members' experience—our members are the contractors who are affected by this—I would say that confusion, anger and resentment are the main things that come through to us. We hear from them daily. We have had thousands upon thousands of messages, e-mails, phone messages and so on from our members.

These are real live quotes from our members: "There are lots of confusing and endless discussions about the regulations, which have

resulted in project stalling and clients not getting work done”; “I feel like I’ve been legislated out of business. I no longer wish to work in the UK”; “Clients are making blanket decisions”—that is where a client will decide that everyone is in IR35 right now—“so I’ve stopped working. The client loses out on the experience that I bring and now I’m not paying any tax at all, so we all lose out”. That would be the best way I can summarise it. It has a huge impact, and people are devastated by how the changes have impacted them.

**Baroness Harding of Winscombe:** Thank you. That is very clear.

**Martin McTague:** The biggest single effect we have seen is on HGV drivers. Quite a few of them have now fallen foul of IR35 and are pulling out of that operation. We all know and we have read plenty of news stories about the impact that has on the supply chain issues. That is the most noticeable shift that we have seen—HGV drivers.

**Baroness Harding of Winscombe:** As a follow-up, particularly from the perspective of the FSB, HMRC estimated around £90 million for the one-off costs of implementation. What is your sense of the level of costs that businesses have had to incur as a one-off to set this up?

**Martin McTague:** We did a report a few months ago where we estimated the total cost of complying with tax legislation. For small businesses it is £25 billion across the whole economy. It cost each self-employed person 52 hours to work through it. If you look across the spectrum of different tax regulations, this is the most difficult for our members to comply with. They find it confusing, opaque and difficult to use. You had a bad situation and you have just made it worse.

Q4 **Baroness Kramer:** You have given us some very powerful anecdotal information. Is there any way in which we can try to get some sense of the numbers that have dropped out, moved to continental Europe or in other ways left their former work and their area of skill?

**Martin McTague:** It is very difficult to get firm data on this because it is a situation in flux. There is a lot of change going on and we have not seen reliable data that would enable you to firmly point to specific numbers. As soon as that is available, I am happy to give it to the committee.

**Phil Pluck:** If we define it just in terms of professional and highly skilled contracting, we did our own surveys and had returns from contractors who were currently working under PSCs with our member companies. Up to 30% of those said that they were going to leave contracting as a result of the environment that they now find themselves in.

**Baroness Kramer:** Any granularity that you can send us would be much appreciated. That is a very powerful number.

**The Chair:** That would be very helpful, especially on the HGV point.

Q5 **Lord Butler of Brockwell:** There is clearly a good effect from IR35, is

there not? We would all agree that contractors ought to pay the tax and the national insurance contributions. You have been referring to some bad effects. Where do you strike the balance?

**Martin McTague:** I think you are right to point out that some people were paying less in national insurance contributions than they should have been. What is difficult to see, though, is the dampening effect that has on the economy generally. We saw a lot of flexibility in freelancers, particularly IT staff, who were able to move around the economy quite easily. Now they are constrained, because a lot of them have had to go into employment or have retired.

**Andrew Chamberlain:** I would say, if we are being completely honest, that there were probably people who should have been employed or paying tax like an employee. In some cases, they are now paying tax like an employee, although they are not always employed, which is a bit of a problem. The problem is that so many other people are swept up with this, because it is very hard to decide that this pot of people over here should be employed and this pot of people over there should not be.

These rules, particularly the rule change in April, have swept up a lot of people who are genuinely in business on their own account and were paying tax quite appropriately before and were not avoiding anything. Now they are swept up and involved in the conversations that we are hearing about: "I'm going to have move abroad", "I'm going to have to close my business", "I'm now going to have to work as an employee, which I don't want to do. It's going to constrain me. It means I can't move around the country picking up the bits of work that I want to be able to do". The negatives far outweigh any positives, in our view.

If it is just people paying the correct amount of tax that we want to get at, we should look at how people and businesses pay tax and ensure that we have a transparent system, rather than doing what we have done here, which is to say, "Let's try to shove as many people as we can on to a payroll somewhere", which seems to be the endgame of this legislation.

**Phil Pluck:** The key positive is that a lot of contractors who were operating under limited companies—who, as you rightly say, perhaps need to be under a different, more transparent tax regime—are now under umbrella status, but the key advantage is that they are under umbrella employment. They did not have any rights under limited-company status before, but if they have chosen to use a compliant umbrella organisation, they now have full employment rights. They may see a reduction in their daily rate because of the new tax regime and the national insurance regime that they are under, but with it come employment rights that sit with them as an overarching employment contract. They can move from contract to contract and still carry those employment rights and that continuity of employment. That is one of the key advantages that has to come from this.

**Q6 Lord Butler of Brockwell:** I want to ask you about the engagers. In your experience, are the engagers correctly applying the rules? If not,

what are the practices that give you the most concern?

**Phil Pluck:** Up to two or three weeks before 6 April, when the private sector reforms came in, we did our own survey and 70% of engagers had not prepared for the IR35 reforms. Part of that was a fear of the unknown, part of it was an assumption that the Government were going to extend the introduction yet again, having delayed it by a year, and part of it was down to the fact that they thought there was another way out of this and that engagers could create a neat package for themselves.

One of those neat packages, which is still ongoing, is blanket bans. Instead of doing a status delivery determination on all the roles they may have that they are outsourcing, they simply brought in blanket bans. Blanket bans were nothing but disadvantageous to contractors and posed a risk, and still do, to the entire supply chain, because blanket bans, by definition, will have errors in them. HMRC has just launched, in the last few weeks, its investigations of various separate firms. It would not surprise me if it is starting with the companies that did blanket bans.

The other factor that has come in is that some engagers have decided to disengage themselves from the reforms by putting another part into the supply chain, a managed service company that will manage all these things for them for outsourced workers. All that has done is add another cost to the supply chain. Ultimately, somebody has to absorb that cost, and in our observation that is often the contractor.

That is one of the key elements that has happened. Engagers have not engaged fully with this. As we sit here today, they continue not to have engaged fully with it, and some are still fearful and ignorant of it. That is partly due to the confusion about how to create status determination and partly down to the fact that they feel that they can simply push this away to somebody else.

**Andrew Chamberlain:** To back up what Phil is saying, we surveyed our members fairly recently—in the last few months. Thirty-eight per cent at that time had not been provided with a status determination statement from their client. It could be that some of them had indeed been blanket banned, and this was their way of saying, “They didn’t do a determination because they didn’t have to, because they just made sure that I was put on to a payroll from the outset”. There are certainly a lot of clients out there who have still not got their heads around this, and I would have thought that they would be starting to worry about HMRC knocking on their doors.

Another question is the extent to which engagers are applying the rules correctly. That is quite a difficult thing to do, because the rules are very complicated in themselves. Determining an IR35 is infamously difficult to do. Clients did not want to have this responsibility shoved on to them and many of them are trying their best. Many of them, and we have had a look, are doing proper individual assessments.

As well as the blanket bans, we also have the problem of blanket decisions, which is where they say that everyone is inside IR35. That is against the rules. According to the legislation, they are supposed to take reasonable care in making determinations, and 21% of freelancers in our survey reported that their clients had determined all engagement as inside IR35 without considering them individually.

So we have big concerns, but it is a very mixed picture. It is probably impossible to apply these rules perfectly and in such a way that you never get any of it wrong and you keep everybody happy.

**Martin McTague:** The only thing I would add is that in our experience engagers have been risk averse. Where they see even the remotest risk of falling foul of an HMRC inquiry, they are choosing to take the least line of resistance and are reaching a blanket determination.

Q7 **Lord Butler of Brockwell:** Following on from that, if I may, I will give you a particular example of this on which we had evidence. It was given anonymously and it cannot be identified, so there is no harm in asking you about it. This was somebody whom it was agreed was outside IR35 and then the engager decided, without giving an SDS, that they would be inside it. The contractor disagreed, found errors in the grounds on which the engager had done it and appealed against it to the engager, but the engager said take it or leave it. You are confirming that that is the case. What this did was determine the contractor's status for tax purposes, but the contractor had no appeal against it. They could not appeal to HMRC. That sounds to me like an injustice.

**Martin McTague:** It is.

**Lord Butler of Brockwell:** Would you share that view?

**Martin McTague:** I definitely would share that view. To be fair, there are also examples of people manipulating the tool to try to get the answers that they think are appropriate to their status. The current situation is a mess. If you fall foul of it, you have no right of appeal. Essentially, if you are working for a big contractor who has plenty of choice about who they recruit, they will determine whatever suits them and you are in no position to challenge it.

**Lord Butler of Brockwell:** You said contractor. I think you meant engager, did you not?

**Martin McTague:** Engager, sorry, yes.

**Andrew Chamberlain:** We completely agree with Martin. The right to appeal is new; it came in in 2021. When the rules came into the public sector there was no right to appeal at all. The new Chapter 10 revisions that came in in 2021 say that the contractor, if he or she disagrees with the determination, can now challenge. The client then has 45 days in which to respond and either give them a new status determination statement or stick with the one they already gave. Beyond that, they have nothing else. There is no legal requirement for the clients to change

their minds. That led us to say that it was almost a futile right to challenge.

However, in our survey, 90% of contractors who did challenge got the SDS overturned, so my advice to contractors has changed somewhat. It used to be, "Well, it's a bit pointless", but now I am saying, "It's worth a go. It doesn't cost you anything and you have almost a one in five chance of getting your client to see sense". I am aware that some clients take it quite seriously and may even say, "Let's go to an independent expert to act as an arbitration service, seeing as you've challenged it, and maybe we'll share the costs of that". Maybe the contractor will pay for it, or the client will, I do not know, but that does cost some money.

You are quite right, though. There is no access to HMRC or some other independent arbiter, which is what this would need. Of course, HMRC could not possibly deal with that, because these determinations are complex. One IR35 investigation that ends up at a tribunal can go on for years. Then the judgment can take a tribunal one or two days, and then a month to write. It would be so difficult to come to any sort of determinative position on each engagement.

**Lord Butler of Brockwell:** In fact, we are talking about individual contractors, are we not?

**Phil Pluck:** Yes. The only slight variance is that, because of a number of circumstances, not just IR35, we are beginning to see a bit of contractor power returning to the marketplace, because engagers and recruiters are beginning to realise that there is a massive skills gap at certain levels in certain sectors. Engagers, we notice, are beginning to soften slightly. Even though the appeal process is clunky and not very well thought through, it is now beginning to show through in terms of whether engagers are willing to be less draconian about blanket decisions and so on. They simply do not have the skills, so they are having to take things more seriously.

Q8 **The Chair:** Thank you very much for those answers. Taking a step back, let us focus on CEST. Is it fit for purpose? What further changes could be made if you do not believe that it is fit for purpose at the moment? I will start with the FSB this time.

**Martin McTague:** In our view, it is not fit for purpose. In the surveys that we have done, there are about 20% of indeterminate results from it. We also see a little cottage industry growing up now of people who have developed tools for answering CEST in the way you want it to be replied to. I feel that any kind of credibility it had has been undermined and it is not doing what it set out to do.

**Andrew Chamberlain:** We do not believe that CEST comes up with accurate summations. We have always said that it has one critical flaw in that it does not test at all for mutuality of obligation. HMRC is pointing to a recent court case right now that it says backs up its view on mutual obligations. I do not want to get dragged into this conversation too much,

but its view is that if there is a contract, there are mutual obligations, so there is always a contract and it does not need to test for it. We would push back a bit on this idea that the Court of Appeal backs up that position. The Court of Appeal says that there need to be sufficient obligations. So we still feel there should be a test in it on mutuality of obligations, and because there is not it is fundamentally flawed.

Finally, we believe, having done lots of experiments and answering the questions in different ways, that far too much weight is put on one question about substitution. If you answer that question in a certain way, you are almost guaranteed to come out with a certain outcome.

**The Chair:** Thank you. That is very interesting.

**Phil Pluck:** CEST is not fit for purpose, but then you have to ask what the purpose is. If the purpose is simply to be a guide but you cannot rely upon it, it is perfectly adequate, because CEST gives you some answers but not all the answers. Mutuality continues to be its main flaw.

The latest figures, which I looked at yesterday, show that there is an indeterminate outcome in 21% of cases. My view of HMRC is that that is how it views CEST: that it is not just a guide but a legal requirement. It views it as a legal definition of an outcome. If 21% are indeterminate, just apply that to a driving test: 21% of you may not have failed, but you may have failed but you can still carry on driving. It is not fit for purpose if it is being used as a legal tool by HMRC. The market has always developed alternatives to CEST that are much more comprehensive. There is the argument that this is not just a role but an individual in the role, so it needs expert advice, which is usually legal.

**The Chair:** Can I jump in there on the market point? Is it possible ever to create a mechanism, a tool, that will give every person who uses it a definitive response?

**Phil Pluck:** No. There are many, many tools out there that are based on algorithms, which are very good but they are not 100%. You have to show reasonable care when coming to a determination. If you can show reasonable care, the best reasonable care would be to use a comprehensive tool and have proper legal advice in place for those roles. That is the most comprehensive point. A tribunal would look at that and say that that is reasonable care.

**The Chair:** In the 20% of cases that are undetermined, what help and support in the form of advice is there from HMRC at that point, and how easy is it to access that?

**Andrew Chamberlain:** There is an HMRC helpline, but it is quite hard to access advice on it, because getting through to it is difficult. I do not have any stats on this, although I think there might be some available. I will look into it and send them to you, if I find any.

The reality for most people who come out as undetermined is that the client will decide that IR35 applies at that point. They would be looking to

the CEST tool to give them that get out of jail card to say, "We've filled in this box and it's outside IR35, so should HMRC ever come knocking, we've got this as evidence". They do not have that, going back to Martin's point about being risk averse, so they are much more likely to proceed on the basis that they will treat this as being inside.

**The Chair:** Do either of you have any views on advice from HMRC?

**Martin McTague:** What I would add to what Andy has said is that HMRC is completely overwhelmed with Covid work right now, and its ability to cope with these kinds of inquiries is limited. It is not at the top of its list of priorities.

**The Chair:** If it is impossible to come up with a mechanism to determine one's status, does this not drive a coach and horses through the entire approach that HMRC and government policy is taking?

**Phil Pluck:** There has been a worrying development over the last few weeks, where we are seeing a number of engagers receiving letters from HMRC—I have seen one and I have been told of others—saying that it is now going to investigate the outcomes of their status determination results. The letter goes on to say, "If you've used another test, we'll ignore that. The only test we'll acknowledge is the CEST tool".

To me, that is taking CEST from a guidance tool to one that it regards as a legal requirement of companies, and that is not the case. It is not a legal tool. That development is concerning us. Your description was that of a coach and horses, and it looks more and more like a coach and horses approach. Yet there seems to be no acknowledgement of case precedent that is beginning to emerge. Even government departments have used the CEST tool and still found themselves with a £30 million bill.

Sadly, I am afraid I agree with you that it looks like a coach and horses approach. That may be because of a lack of resources, but it is beginning to concern us.

**Andrew Chamberlain:** There is the argument that we need to clarify our employment status rules. That argument was made, for example, by Matthew Taylor in his review in 2017. Government has committed to doing that work, but we have not seen very much activity on it since then.

If we could get clearer rules on employment status, that would be the key to sorting this out. The rules that we have right now are not clear. Some people support that and say that it is complicated, so we have a complicated set of case law around it, but it makes it extremely difficult for anyone to assess their status with any certainty. It is not easy to do.

**The Chair:** Very good. Thank you very much.

Q9 **Lord Butler of Brockwell:** Can I ask one supplementary? It is a bit cheeky. Mr Chamberlain, what is the critical question in CEST that you said determines the answer that you are going to get?

**Andrew Chamberlain:** The question is asking the client, "Do you have a right to reject a substitute?" If the client says, "Yes, I have a right to reject a substitute", it is not impossible that you come out of there with an outside-IR35 determination, but it is extremely hard, and you have to answer the following questions in an almost precise manner to get there. Once you have answered that question and said, "Yes, I have a right to reject a substitute", it is very likely, in our experience, to come out as inside IR35.

Q10 **Baroness Kramer:** To follow up on the CEST tool, do we have any idea of how the pool of 20% of cases that fall into the indeterminate category and CEST cannot give you an answer on break down? Do 50% end up inside IR35 and 50% outside? Is it 80:20? It seems to me that that is a fairly interesting number for giving one a sense of how well this is working.

**Phil Pluck:** This is how HMRC has worded it in the guidance. I am quoting figures that are now a month or two old, so 20% does not appear in this. The guidance says that 85% of the status determinations are accurate and that in 15% of cases it cannot determine the outcome.

It is saying that 85% are accurate because it comes out with a status determination, but I would challenge that, because that status determination is not necessarily correct. Court precedents and tribunal precedents are now proving that to be the case. Our own suggestion is that it is probably only about 50% to 60% accurate, because it is 12 questions as opposed to 47 or whatever it needs to be for a particular role. I am afraid that the market decided some time ago that it will develop its own status determination tools as a result of those figures.

Q11 **Baroness Kramer:** Thank you. Anything more that you can give us in the way of numbers would be extremely helpful, particularly something to try to narrow down all those uncertain figures.

My question goes back a bit to a question asked by Lord Butler, because it is focused on the off-payroll working rules and the impact they have had on the way engagers recruit contractors. I know you gave some answers on that, but if there is anything more to add I would be grateful to hear it.

I would also like to get a sense of what the impact has been on the rates that contractors are paid. Do you have a sense of the difference now between gross and net of any deductions? I am trying to get a sense of what it is like if you are the individual contractor and you have been shifted from one employment status to the other.

**Martin McTague:** The main trend that we have seen is that, if you have market power, essentially you put your rates up and you can encompass the new position in your inflated rates. If companies do not have market power, most of them are ending up in umbrella companies. Employees of umbrella companies, if they are well run and are authentic umbrella companies, effectively have employee rights, but if they are not, which

many are not, you could end up in a worse position because you have accepted a poorer offer and you will end up with no rights.

**Baroness Kramer:** Are you saying that the good umbrella companies are giving value for money?

**Martin McTague:** You are back into having an employment status, at the least. You are on the same footing as everybody else who is employed, but many of them will find that ultimately those umbrella companies are bogus and they will not end up getting their full rights.

**Baroness Kramer:** Do we know what the rake-off is typically for an umbrella company?

**Martin McTague:** I do not have accurate figures, but somebody else might.

**Phil Pluck:** If you were to move today from PSC status or limited company status to umbrella employment, there is a fair chance that if you went with a compliant umbrella company it would tax you in the way an employee should be taxed in the UK. Therefore, you will lose about 20%, because assuming that the assignment rate has not changed and the engager is not paying any more, you will lose your tax-efficient status and will move into employment under an umbrella company, so you will legitimately lose about 20% or something on what you got as a PSC.

That has created a worrying trend in umbrella companies in that some umbrella companies are trying to lure the contractor with offers that are simply unrealistic. They will say, "You don't have to lose 20%. In fact, you only have to lose 5%, or you don't lose anything because we can offer you this very tax-efficient loan scheme or we can offer you some other form of tax efficiency". That is fiction. Compliant umbrella companies therefore get a bad deal, if you like, because contractors complain that they are losing so much money, but they are losing so much money because of their new tax status.

You asked what the cut is, or the margin. A typical umbrella company will charge between £15 and £25 per week for all the services that it provides. The model is very high volume, low margin, because out of that comes £2 or £3 worth of profit, hence you need the high margin in terms of contractors. What has happened as a result of the IR35 reforms is a massive increase in umbrella companies and in umbrella companies that are offering non-compliant and unlawful offers to try to lure contractors who have seen 20% of their income disappear.

**Andrew Chamberlain:** Maybe what you are getting at here is that when someone is put inside IR35, there is now a charge for income tax and national insurance as well as employers' national insurance. This is the area where everyone gets upset and argues over who should play the employers' NI.

What happens now is that you have your initial day rate. Let us say that you were on £400 a day and you were being paid gross. All of a sudden

you are paid via an umbrella company, or you are on the payroll of the client or an agency, or someone's payroll somewhere. They have to pay the employers' NI because they are the fee payer, but they do not want to pay that. If they are an umbrella company, as Phil just said they are operating on quite low margins, so they cannot afford to pay 13.8% on top of whatever they are paying an individual. So you get a new day rate. Your new day rate, or your assignment rate—the assignment rate is the original rate—will probably be around 20% less than it was before.

You will still be taxed further on that, but that will be taken out of the employer's NI plus the apprenticeship levy, which is often chargeable as well. So individuals are paying an apprenticeship levy, which is designed to be paid only by the very biggest employers. They are the ones who are supposed to be paying it, but in effect individuals are now paying it. They are not paying it directly, but they are paying it indirectly. This has caused the most resentment, anger and confusion, out of everything else within these rules: that once it has been deemed that IR35 applies, this tax now has to be paid and there is a big argument over who should pay all of it.

**Baroness Kramer:** To look at it from the opposite perspective, you talked a bit about the decisions that contractors are making—whether they remain available, whether they are going abroad, or whatever else. Is this a minority issue and something quite at the margins, or is it having a major impact and seriously impacting the flexibility of the labour market?

**Martin McTague:** In the current labour market, because it is tight there has been a smaller impact than I think there would have been in normal times. Take something like HGV drivers. The impact there is immediate and very large, in that you have a clear example of where even market pressure cannot drive these guys back, because they simply cannot afford to pay the new rates.

**Baroness Kramer:** Do we know what proportion of the HGV market is in contractors?

**Martin McTague:** The number that is bandied around a lot is 100,000 short. The figure that I have heard quoted regularly is that, of that, 20,000 are IR35 impacts. I cannot give you an accurate figure, but I can certainly look into it.

**Baroness Kramer:** Andrew or Phil, do you have anything to add?

**Andrew Chamberlain:** In our survey, 35% of contractors had left self-employment. Some of them have gone into umbrellas, so they are now employed. Some of them have just stopped working, some of them retired early and some of them have gone abroad. That are a lot of people leaving self-employment, but many of those remain in the labour market because they are still working, perhaps even on the same project that they were working on before but now via a new arrangement. So it is a bit hard to understand, but it is a big number.

Anecdotally, there are a lot of signs that the contracting market has shrunk. You may be the kind of contractor who sees yourself very much as working outside IR35, in business on your own account. For many people it is almost a matter of identity. They will refuse work that is inside IR35, because they do not want to work via an umbrella company or anywhere else. They are talking about exploring opportunities abroad. Some are already doing it. I might be able to get you some figures on that as well. I will have to send them afterwards; I do not have them in front of me here. It is not completely marginal, but it is not huge either.

**Phil Pluck:** Our figures are not far off Andy's. I would say that around 30% at the point of 6 April were deciding to give up contracting completely. Some moved into umbrella, but not the whole 30%. I cannot quantify where the others went, because we can only measure, under our models, where they went to, but 30% left contracting. We know that, because of leaving the European Union, because of the pandemic, many of them have simply not returned. They are high-skilled individuals who we need, but they are in short supply at the moment.

**Baroness Kramer:** Are you saying that the impact is far greater on the high-skilled end of the market than it is on the low-skilled end of the market? Presumably you do not have that market power.

**Phil Pluck:** We tend not to engage in the low-skilled end of the market. We want nothing to do with the zero-hours element of it, so is it generally the high-skilled area that we work in, either in PSC or in umbrella.

**Andrew Chamberlain:** It is the same for IPSE. Our membership tends to have more high-skilled people in it, not that I am saying for one moment that HGV drivers are not highly skilled. I think they probably are. That was a whole area that we had no idea existed: that people were operating as personal service companies within that industry. It was complete news to us when that came out, so there could well be all sorts of other sectors where we are unaware of the impacts it is having because they are not within our main membership.

Q12 **Baroness Noakes:** I was going to explore umbrella companies, but we have largely covered that. To summarise—let us stick with compliant umbrellas and not the ones that are trying to evade the law in some way or another—are they net good or net bad? A quick response.

**Phil Pluck:** Umbrellas are a net good, but we have a series of highly compliant ethical umbrella companies that operate in a sector that is unregulated and has not been properly policed for decades now. That has produced an increasing level of non-compliance and unlawful behaviour. IR35 also brought about a series of accountancy firms that suddenly realised that they were going to lose vast numbers of their clients but had no alternative firms to go to, so they were very quickly starting umbrellas without a real understanding of the complexities of employment law. Essentially, a compliant umbrella is an employer of contractors who move from contract to contract. None the less,

employment law exists in their world as it does in a standard employment model.

So it is a net good, but only if they are fully compliant, independently tested and, in the absence of regulation, tested against a set of rules that my organisation—and others, I should point out—apply.

**Andrew Chamberlain:** We would say that compliant umbrella companies are clearly much more desirable than non-compliant umbrella companies. There is a bit of an issue that we have to face up to here, which is the idea that your employer is an organisation that you have never met, does not know what you are doing particularly well on a day-to-day basis and with whom you do not have an ongoing working relationship. That slightly obscures the whole employment relationship. It is not necessarily a bad thing if it is done properly, but it is not totally obvious to me why it would not be better if some of these people were just employed by the business that ultimately is engaging them to do the work for them.

**Martin McTague:** The only thing I would add is that the pressure that is going to come from non-compliant umbrellas will make it very difficult for compliant umbrellas to carry on. It will erode their ability to trade. Ultimately, unless HMRC gets a grip of these bogus umbrellas, the whole thing will collapse.

**Lord Butler of Brockwell:** I was hoping you would say that the good would drive out the bad, but you are saying that the bad is going to drive out the good.

**Martin McTague:** I think the bad has more power and will drive out the good.

**Phil Pluck:** I have seen these examples. If your day rate is £500, the non-compliant umbrella will say that you can take home £450 of that, whereas a compliant umbrella loses out in that sense because they say, "I'm sorry, no, you can only take home £300 because we have these legal deductions to make". So there is great pressure on compliant umbrellas.

Among all that, there are some very clever, non-compliant umbrellas that will create extremely convincing packages that say, "We can offer you a tax-efficient scheme. We're HMRC registered". The reality is that we all are. "At the same time, we've got this legal letter that says this is a perfectly legal system to run". Compliant umbrellas never offer that. Contractors who are wise know that, but we also have to accept that IR35 has forced a lot of people into umbrella employment and therefore they are not necessarily as educated as they could or should be when they choose an umbrella organisation.

**The Chair:** To paraphrase, is IR35 driving up tax avoidance?

**Phil Pluck:** Yes, it is. We have seen very clear evidence that it has driven up tax avoidance. It has driven up tax avoidance in many different forms.

We now live in a much more advanced cyber world, so the tax avoidance schemes are sitting offshore and HMRC does not have the powers to go in search of those. It is very easy to set up a company at Companies House and then have a series of intermediaries, but most of them are based offshore. Finding those directors is getting harder and harder. IR35 reforms have just produced a wave of a new population of contractors for those people to try to pick off. So the answer is yes.

**Q13** **Baroness Noakes:** My final question relates to the health and social care levy, which was referenced earlier. Obviously that changes the equation of the advantages of using PSCs because of the tax on dividends and the differential rate of national insurance. What impact do you think that is going to have—we will not know until we get into next year—on the contractor market as a whole?

**Andrew Chamberlain:** One of the concerns that we have already about the levy is that there is an increase in employees' and employers' national insurance. As described before, many people now working inside IR35 are effectively paying both of those, maybe not directly but fairly nakedly indirectly. That will double the impact on those individuals when the 1.25% hits each one of them. That will be a 2.5% increase for them.

To answer your question about whether the additional tax on dividends will make PSCs less attractive, I am not sure it will. I hope it will not. When you ask people why they incorporate, business tax is not one of the first things that many of them say; it is usually about the protection of personal assets and projecting a professional image. Tax is a secondary concern. I hope that the additional tax burden placed on dividend tax will not make too much of a difference there.

**Martin McTague:** My impression is that personal service companies have gone through a pretty torrid time during Covid and that a lot of people had lost confidence in it and were looking at other ways of working. This might be just another nail in the coffin.

**Phil Pluck:** I have written down "nail in the coffin". The answer is yes, the feedback we get from the PSC clients who work through our companies is that it may well be a deciding factor in whether they continue, so we may end up with another drop-off in skills that are not available to us.

The other element is the entire supply chain. You have an engager, then you have a recruitment intermediary and then you have an umbrella employer as an alternative. The levy is going to attach itself to all those companies. They will all incur extra cost. We understand why, we understand the rationale behind it, but the real question is whether the assignment rate will take account of that. If it does not, it adds a further burden of cost.

Bearing in mind that umbrella companies work on very low margins, for some umbrella companies there may well be a telling difference between survival or not. For those who are working in areas such as healthcare in

the public sector, the assignment rate is unlikely to increase because government funding to those departments is unlikely to take account of that, so that cost will have to be met somewhere else.

Ultimately, that cost will trickle down to the employer part of the chain, which is the umbrella, and it may well have a telling effect on some of the smaller umbrella companies or umbrella companies that are working in low-paid areas or in government/education/healthcare. How it will materialise we still do not know, and we are still doing our own analysis, but the cost is quite sustainable.

**Baroness Noakes:** Will it affect the umbrella companies or the individuals who are working under an umbrella company?

**Phil Pluck:** The levy effectively starts through the employer.

**Baroness Noakes:** Yes, but it does not sit with the umbrella company, does it, it is going to end up with the—

**Phil Pluck:** The umbrella company is going to say to the supply chain, "How do we afford this extra cost, bearing in mind that our profit margin is so low?" If the supply chain does not respond, I do not think it will affect our members so much because they tend to be the larger-scale umbrella organisations, but it could have a telling effect because somewhere that has to count. If that takes up the sort of percentage increase that we are beginning to look at, it could well be the end of a smaller or medium-sized umbrella company.

Could they push the cost down again? Yes, they could, but ultimately that affects the contractor. We have to understand that umbrella companies exist in a very competitive market. Even though there are preferred supplier lists saying, "You can choose one of these umbrellas", the contractor could still go to one of those umbrellas. So I am afraid that I do not know what the outcome will be. What I do know is that we are already beginning to see some worrying signs about the cost base of certain models of employment.

Q14 **The Chair:** We have heard a lot about the problems. What are the solutions to some of them? If you were the Finance Secretary, would you be telling your officials, "Here are three aspects of how this policy is being implemented that I would like you to review", CEST being one? Is it at the other end of the spectrum and you say that tinkering will not work and we are going to have to start all over again, or is it somewhere in the middle? Can I ask just for a sentence? I think we all understand and see the problems. I am trying to look for some of the solutions.

**Martin McTague:** I think Andrew Chamberlain hit the nail on the head when he said that it is probably employment status. That is the root cause of the problem, is it not? We are dancing around that particular issue. If it is clearer whether you are self-employed or employed and what your rights and responsibilities are, it would avoid a lot of these issues.

**The Chair:** You are saying that it is a legislative—

**Martin McTague:** Ultimately we cannot avoid that. That is where it is going to end.

**Andrew Chamberlain:** I would say rip it up and start again. The IR35 has been a bad piece of legislation since its very inception in 2000. I do not think it has been improved in the remaining 20 years. The changes this year have made it more disruptive. It has meant that more and more people are having to deal with it. It is causing lots of distortions and complications in supply chains, and I believe that it would be much better to do away with it and think in different way about how we tax work. If we started with a blank piece of paper, I do not think we would end up with this.

**Phil Pluck:** I would say in an ideal world, “Rip it up and start again”, but after my discussions with various government departments and HMRC I would say that that is not going to happen, so let us be pragmatic about this and just try to get HMRC to recognise that it is not the expert in this. HMRC has created the CEST tool and should call it guidance. It should allow what has happened now, and that it is for the marketplace to create the type of status determination tools that are already out there and for HMRC to relax on this so that the marketplace and tribunal case precedent can start to dictate what it should look like. If we let tribunal precedent do that, we will end with a series of tools that can be insurable and that the marketplace can rely on, because the people producing these tools already have to live and die by them. That would be my pragmatic suggestion, if we are not going to rip it up.

Q15 **Baroness Harding of Winscombe:** Do you think that that pragmatic solution would leave us at a disadvantage against our competitor countries? Would it see this drift of talented contractors back to Europe?

**Phil Pluck:** I think we already are in that position. I have seen very largescale project management departments and back-office departments go to Dublin, Brussels and France, so we are already there. Will they come back? No, because the regimes that exist in Europe—I cannot speak for other parts of the world—are not as draconian as the systems that we have been discussing today. I think we will be at a disadvantage and it will cost us more to coax those skills back from central Europe, which is where most of them have gone to.

**The Chair:** That is very interesting.

**Lord Butler of Brockwell:** Are we saying that there is more unfair and unequal treatment between employees and self-employed people in Europe than there is in the UK?

**Martin McTague:** I had the impression that we had a competitive advantage before and we have lost it.

**Andrew Chamberlain:** Yes, I would agree. It seems as if there was a time when the UK had a reputation for being an easy place to start up in

business, to be self-employed, and now there is a sense of a huge compliance burden, a punitive tax regime, which makes it much less attractive overall.

**The Chair:** Unless there are any further questions, thank you very much indeed for a very useful session. That is great, thank you.