Economic Affairs Committee

Finance Bill Sub-Committee

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

Monday 6 December 2021

5.10 pm

Watch the meeting

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

Evidence Session No. 2 Heard in Public Questions 16 - 31

Witnesses

I: Meredith McCammond, Technical Officer, Low Incomes Tax Reform Group; Colin Ben-Nathan, Chair, Employment Taxes Committee, Chartered Institute of Taxation; Alice Jeffries, Lead Tax Adviser, Confederation of British Industry; Stephen Ratcliffe, Legislative and Policy Committee, Employment Lawyers' Association.

Examination of witnesses

Meredith McCammond, Colin Ben-Nathan, Alice Jeffries and Stephen Ratcliffe.

Q16 **The Chair:** Good afternoon and welcome to the second session of the Finance Bill Sub-Committee. Could you introduce yourselves, please?

Meredith McCammond: Good afternoon. I am a technical officer with the Low Incomes Tax Reform Group, otherwise known as LITRG.

Stephen Ratcliffe: I am a partner at the law firm Baker McKenzie LLP in the employment compensation team. I am also a member of the Legislative and Policy Committee of the Employment Lawyers' Association, which is an association of employment lawyers representing both employers and employees.

Colin Ben-Nathan: Good afternoon. I am chair of the Employment Taxes Committee at the Chartered Institute of Taxation. I also work with KPMG, but I am here in my capacity as chair of the Employment Taxes Committee.

Alice Jeffries: Good afternoon. I am the lead tax policy adviser for the Confederation of British Industry.

Q17 **The Chair:** Brilliant, thank you all for joining us. I will start with the first question. How has the implementation of the off-payroll working rules gone for businesses overall? How well were businesses prepared? Has HMRC been giving the sort of support that has been required? Tucking another question into that big question, how many individuals do you think have been affected by this change?

Alice Jeffries: You know the history of the implementation; we discussed it briefly in the previous session. It was delayed first of all from April 2019 to 2020 and then to 2021. The CBI's members were very supportive of the original delay, because there had not been a great deal of time to go through the review of the various contracts that they had in place and to implement the procedures and tools that we have been talking about in these sessions.

By April 2020, the picture was a lot more mixed. A lot of businesses had put that money into building compliance systems and the time and energy into reviewing their contracts, and an extra delay was more damaging to them because it created more uncertainty for their contractors and their relationships with those supply chains. By the time we got to April 2021, most of our members who are directly affected by this were very happy to see it implemented in full and to implement those compliance systems in the way they had been expecting.

In the context of the second part of that question about HMRC and the support that it was providing, for most of our members, part of the reason why they were not prepared by April 2019 was that they did not feel they had that support from HMRC. Even where they had customer compliance managers—CCMs—in HMRC directly connected with their business, most of them heard from them for the first time late in 2020 about how they were implementing those systems. They do not feel they have had the support in creating compliance systems that do what HMRC expects them to do. We have talked a lot about the CEST tool; I am sure we will talk more in this session on how that impacts engagers and the flaws in that.

Within the limits of the system, business has implemented as far as it feels it can, but there are still a number of flaws with how the system operates that they are dealing with.

The Chair: Excellent, thank you.

Colin Ben-Nathan: Yes, I would agree with a lot of that. I think the answer is: much better prepared than the rollout in the public sector in 2017, which was very rushed. I think the extra year's grace was welcome. I agree that HMRC has done a lot on communication, upgrading the guidance and making modifications to the CEST tool, but again I suspect we will return to that. Altogether, I think they are much better

prepared than they were in 2017, and the extra year's grace was welcome.

Stephen Ratcliffe: I have very little to add to what has already been said. We will certainly come back to CEST.

The Chair: We will.

Stephen Ratcliffe: I can tell already. There have been teething problems with that. It is probably fair to say that the users, the contractors, who were not ready by April 2021 were not going to be ready. There is always an education piece, particularly with certain smaller entities and with those who are setting up in business in the UK for the first time, but that is not driven by the timing of the implementation.

The Chair: Finally, Meredith, anything to add?

Meredith McCammond: As has already been said, businesses were not in the same kind of uncharted territory that they were in 2017. Lots of them will have been supported by agents that have already been through the 2017 changes in respect of public sector clients. Those without agents may well have been supported by agencies. A lot of big businesses use agencies to take on their limited company contractors and so on. I know that a lot of work was done in the recruitment sector by agencies and umbrellas wanting to upskill their clients.

Those two things, and HMRC's real push and drive to produce some quite good products, meant that businesses were probably better prepared than we thought they were going to be.

Q18 **The Chair:** Great. That is a very helpful overview. A quick question to Alice at the CBI. Could you give us your view on the cost to business? I think it was a £19 million one-off cost. How is that figure is standing up to scrutiny?

Alice Jeffries: Interestingly, it is now £19 million compared to an original estimate of, I think, £14.4 million. When came before this committee previously, we worked that out as a cost of £180 per each of the 60,000 engagers and 20,000 agencies that they had recorded. At that time, we were aware of larger businesses with costs in the region of £100,000 to £700,000 per business. I do not think any of that has changed. If anything, the costs have increased over time. We thought it was a massive underestimate before and we think that is still the case now.

One of the things that were not built into those previous discussions, because they were happening pre-implementation, is the ongoing compliance costs. That £19 million is talking about initial reviews of existing contracts and creating compliance systems. It is not talking about training hiring managers on an ongoing basis. It is not talking about dealing with contractors every other week and the disputes that might arise for the next several years if you continue to engage

contractors on that basis.

I do not think I have seen an estimate from HMRC about what it considers those costs would be to business, but business is certainly looking at an ongoing compliance cost that is probably larger than the one-off cost that HMRC originally envisioned.

The Chair: Excellent, thank you for that.

Q19 **Baroness Harding of Winscombe:** First, I have to leave early, so please do not take it personally when I have to walk out later. We understand that HMRC has worked hard to inform and support businesses—a couple of you have alluded to that—in preparing for the change in the rules. Could you give a bit more detail on the support that HMRC has given? How good have its webinars and one-to-one discussions been?

Alice Jeffries: As you say, it has run a series of webinars and it is still running some of those. A number of the businesses that we have spoken to have said that they come in at too low a level, so they are not hitting where the larger businesses with the more complex situations have issues. It is not engaging with technical issues around particular questions in CEST, for example, or concerns about the way the questions interact, which is another issue. It is dealing with it much more in a high-level "What is the system?" way, a basic introductory piece. I am sure that is very helpful to a number of the smaller businesses that are unaware of the system, but it would have been helpful to have that education piece done three or four years ago and then go into more detail for the specific larger businesses that need more detailed help.

Colin Ben-Nathan: I would agree. I think the problem is that in judging employment and self-employment for tax purposes, you are dealing with a whole spectrum of situations and lots of nuance. You have lots of different types of people who you are considering, particularly in large organisations, and it is very difficult for HMRC when communicating to the broad population to focus on particular issues. CEST, for example, as I am sure we will come to, is a relatively blunt tool. It is probably as effective as it can be but it is blunt. And albeit subject to a couple of points on mutuality of obligation which I suspect we will come to later.

The difficulty, as I say, is the spectrum of situations, so that people will inevitably have questions. In webinars, for example, there will be questions. It is very difficult for HMRC, understandably, to deal with those questions in real time, and I am not sure it has the time to follow up with them afterwards either, although lots of questions are raised. The guidance is much better than it was, but again you are dealing with particular sets of circumstances, particularly for large organisations.

When identifying personal service companies, are they those that you are engaging with one-to-one or are they part of an outsourced service? Sometimes it is very difficult to isolate them. Dealing with all the criteria and hallmarks is complicated and nuanced. It takes time, money and often professional advice. Frequently, where you are on the cusp or the

position is unclear, then advice needs to be taken, particularly by larger organisations.

Stephen Ratcliffe: Yes, I would agree with that. The guidance that has been given, the webinars, have not been bad. They are fine for what they are intended to achieve, which is that they are introducing the topic of IR35 to those with no or limited knowledge. Similarly, the guidance is helpful, so far as it goes, in that it introduces some concepts that are dealt with in CEST and the way in which HMRC will interpret particular questions, often in a way that is not necessarily apparent from the questions themselves.

The challenge we have, and this is not unusual for HMRC guidance, is that it very typically veers towards the easy example, and those of us on this panel I suspect deal with the difficult examples. For anyone who does not fall into the categorically very obviously inside IR35 bucket or the categorically obviously outside IR35 bucket, in that enormous grey area that sits between those two poles the guidance is not perhaps as helpful as we would wish it to be.

Q20 **Baroness Harding of Winscombe:** What would you have HMRC do? What areas should it be focusing its support on?

Stephen Ratcliffe: I wonder if this is an opportunity to raise CEST.

Baroness Harding of Winscombe: We will get there.

The Chair: We will come on to CEST in a moment, I promise. I know everyone is longing to talk about CEST. I am, certainly.

Meredith McCammond: Shall I answer that? First, I think the problem with the HMRC webinars, and I have sat through a fair number of them now, is that they merely repackage the guidance that is already available on GOV.UK. When somebody asks a specific question, the HMRC panel members sometimes seem to be too nervous to answer it, so they will just give a link back to the GOV.UK guidance. It kind of traps people in a loop, where people attend the webinar thinking they will be able to ask specific questions and actually it brings them no further forward. Improving webinars would be a step forward.

More generally about the guidance from HMRC, I would like to commend it. I think it has done a very good job of tailoring the guidance for different audiences. For one of the first times that I can recall, we have seen guidance for agents, end clients, fee payers and workers. It has done sector-specific workshops, so it has targeted oil and gas and different sectors. It has created all sorts of ways of reaching out to workers with factsheets, flowcharts, case studies, blog posts and social media things. It has thought creatively about how to reach people.

The main thing I would like to raise as noteworthy is that, for the first time in 20 years, it has put out some guidance for people on what working through an umbrella company means. That is really important, because there was a huge gap there previously. HMRC worked quite well

with stakeholders in asking us for input and feedback on those products. Overall, I would like to give HMRC a kind of pat on the back.

The Chair: It is very interesting to hear that. Thank you for that.

Q21 **Lord Butler of Brockwell:** I am afraid that I am going to keep you off CEST for one more question so that the Chair can have his go on that. What are the main criteria, the main aspects, on which employers have had difficulty in determining the status?

Colin Ben-Nathan: You have the basic tests of control—the where, the when, the how, et cetera. You have substitution and the nuances on substitution, whether substitution is qualified or unqualified and fettered or not fettered. You can move on to other tests within—I am afraid I am going to mention it—CEST, which is to do with equipment and whether equipment and costs are significant or not significant.

The problem is that the whole area is fraught with words where judgment is required. Understandably, because we do not have a codified test of employment, this is all to do with case law. Every time a case comes before the courts, you have to go through Ready Mixed Concrete and all the rest of the case law to get to a position. They are judgmental, these questions.

Understandably, HMRC is reluctant to put percentages on what is significant and what is not, relative to revenues or fees and so forth, so all the time judgments are having to be made. That is why HMRC has added quite extensive guidance and examples on the very questions that it is answering. Part of the problem sometimes is that engagers or workers do not necessarily read the guidance at the same time as looking at the questions, because the questions can appear deceptively simple, but there is guidance behind that. As I say, even the guidance has to be taken with some nuance as well.

Q22 **Lord Butler of Brockwell:** Would I be right in thinking that an industry has grown up to manipulate the use of the criteria? Would any of you like to have a go at that?

Colin Ben-Nathan: I am not sure I have experience with that. The hirer and the worker may have different perspectives on the answers to some of those questions, and understandably so. You see cases flip-flopping in the courts quite often. As was mentioned in the previous session, one of the key issues here is secondary national insurance contributions. They are a significant cost. They will be added to by the health and social care levy, so there are vested interests, if you like, in looking to see whether the result can be in or out.

Stephen Ratcliffe: I would not say that an industry has grown up as a result of the reforms to IR35. I speak as somebody who has been advising on the boundary between employment and worker and self-employment for 20 years. There has always been a need in the right circumstances for professional advice on tricky cases, but I think it is true to say that there are those who are unhappy with the CEST tool and

alternatives have grown up that are said to be more sophisticated or in some way to give you a more accurate answer.

All I would say is that the delineation between someone who is an employee and someone who is not has been the subject of court decisions for around 200 years now. The test that many of us will refer to, drawn from the Ready Mixed Concrete case, is over 50 years old. That case law continues to develop. In fact, we have seen a number of cases even over the last five years on the question of who is an employee and who is not, both for tax purposes and for employment purposes.

It is correct that there is an industry of advisers, of which I am one, who deal with the difficult cases, but unfortunately that is because there is an infinite number of examples of work and there will continue to be developments in what work is. As a result, there will necessarily need to be developments on where the boundary lies.

Lord Butler of Brockwell: Thank you. Does either of the two ladies want to come in?

Meredith McCammond: Employment status is notoriously difficult, and the tests are confusing, subjective and difficult to apply, especially at the borderline. But not all cases are those cases. There are a lot of cases where it is clear-cut. Where it is not a question of the technical status determination being difficult, the challenge for businesses is the admin burden that they suffer. Alice Jeffries alluded to it earlier, but the costs of having to implement systems and processes and having to recruit people to manage the IR35 workload have been significant.

Lord Butler of Brockwell: Are you aware of a lot of cases of contractors and engagers disagreeing about the determination of status?

Meredith McCammond: I do not represent businesses or contractors in that kind of way, so I would not have any personal experience of that. That question is probably more for somebody else.

Alice Jeffries: I can probably contribute to that. A lot of businesses had a large number of contractor relationships before the implementation of the rules and have reviewed them over the last few years. They were meeting their compliance burden by doing a reasonable individual assessment of each case. In several cases, they were looking at thousands of contractor relationships within their businesses.

One concern raised was that contractors would not feel that they had the power to challenge once the burden for challenges had shifted from being directly with HMRC to their engager, and therefore to the person paying their fees, ultimately. The reality is that that was not the position that businesses ended up in. One business that reviewed over 4,000 cases found that 30% of its determinations were appealed. We heard in the last session that about 20% of those appeals are successful.

Depending on the industry and the balance of power between contractors and engagers, you might get a different result, but one thing that is clear

is that several of the industries where contractor relationships are quite common—for example, defence, construction, logistics and IT—have a strong, wide skills gap and a strong contractor power within that market. That is strengthened only when contractors have chosen to leave the market as a result of these rules. Many of them felt quite able to appeal against engagers and to raise disputes, and that process is taking up a lot of time.

Another of the businesses that spoke to us about this said that for the 20 full-time employees they have working on IR35, the majority of their time is spent on disputes.

Q23 **Lord Butler of Brockwell:** If I may, I will pursue a question that I raised in the last session. Do you think there is something wrong with a system in which the engager determines the tax status of the contractor and the contractor has no recourse to HMRC to challenge that?

Colin Ben-Nathan: From the immediacy of tax deductions or otherwise applying, and national insurance payment at the time, I understand the point you are making in the sense that, subject to supply and demand et cetera, the engager will effectively need to make a call on that point. But iIt will be interesting to see what happens at the end of the tax year when tax returns have to be filed, because it is still open to the individuals to say, "I don't think the law works this way, in fact. I'll make full disclosure, but I think it works this way". We are not there yet, because of course we only started on 6 April; we have not had a full year. When tax returns are submitted, it will be interesting to see how many individuals choose to raise that point with HMRC. It will come full circle.

Alice Jeffries: That point was raised to us by businesses as one of their newest concerns, because from their perspective, yes, they can make the determination. The assumption so far has been that the main risk they face is putting somebody outside the payroll walls when they should have been inside, they would not deduct the necessary tax and they may be investigated by HMRC.

They are now looking at the risk that sits on the other side and saying, "What if we put them inside payroll and deduct all that tax, including our employer's NICs?" If the individual goes through their self-assessment and declares themselves to be self-employed, there is no recourse for the business at that point to reclaim any of the tax that was deducted from that pay or that they paid on behalf of that individual. They are looking at risks and costs on both sides if they get the determination wrong either way.

Lord Butler of Brockwell: I thought you said that there is no recourse to the employer, so is the employer bearing a risk?

Alice Jeffries: If the employer decides that an individual falls within payroll, they will then be responsible for paying the employer's NICs. We talked previously about how that might be reallocated and effectively paid by contractors in some situations, but on its face they are responsible for

that employer's NICs. If the individual then says in their self-assessment, "I am self-employed", they may be able to claim back some of the income tax that was paid, but the business has no way of reclaiming the employer's NICs that were paid. Businesses have raised the point about potential offset mechanisms, but HMRC has not properly engaged on this point as yet.

Colin Ben-Nathan: The point about employer's national insurance and unscrambling the whole thing will be interesting. I would reserve judgment on that. A number of employers might well want to unscramble the position. If it is found and held that IR35 and off-payroll working does not apply, it does not apply all around. It will be interesting to see how that develops, but we are not there yet.

Lord Butler of Brockwell: If I am a contractor and I wish to challenge my engager's view of my status when I put in my tax return, is my recourse then to a tribunal?

Colin Ben-Nathan: Yes, in effect.

Lord Butler of Brockwell: It would be quite an expensive thing to take on.

Colin Ben-Nathan: Unless, of course, HMRC agrees.

The Chair: Very interesting. Baroness Kramer, then I will come in.

Q24 **Baroness Kramer:** A tiny question. Ms Jeffries, have we moved to a point where we have two classes of contractor: those with scarce skills, a lot of expertise, who are in a very strong position when they are dealing with a potential engager; and those who have ordinary humdrum skills, who are easily replaceable and who are in something of a take it or leave it situation?

Alice Jeffries: I think there is complexity in the middle between those two categories in the form of individuals who may not have specialist skills particularly across the whole country but do have them in a geographical area, or you may have individuals who have the option to work for smaller employers, so they take advantage of the fact that there is competition within their market between large and small companies, the larger within IR35 and the smaller not.

There are complexities within that, but we do see the more skilled end of the market being much more able to choose to push the costs back on to the employer or the engager and to choose what they do within the market in a way that perhaps the other end would not be able to.

Q25 **The Chair:** CEST at last. Where does one start? Let me start with a simple question that I asked the previous panel. Is CEST fit for purpose? Can you see ways in which it could be rectified if you think it is in some shape or form fit for purpose? I will ask Stephen first, as I think you wanted to talk about it.

Stephen Ratcliffe: The question requires that you define its purpose. I think there has been confusion over what CEST is intended to achieve. It is not a codification of the law on employment status. It could never be that. I query whether that could ever even be achieved on the current law. It is an indication of the cases that HMRC will not seek to challenge. If you accept it as that, and you accept that that probably means HMRC has placed the bar a little higher than a tax tribunal or an employment tribunal might, you can understand a little better how the answers to questions on CEST are interpreted.

The challenge with CEST is the gap, by which I mean the cases that CEST is unable to answer. If you consider CEST as a tool that is intended to indicate whether HMRC will fight or not, it is frustrating that in 20% of cases HMRC will not tell you. In a sense, it would almost be better if in that 20% of cases the system tossed a metaphorical coin and just picked one side, because that would avoid an awful lot of back and forth with HMRC trying to get through on the hotline. It would avoid an awful lot of professional advice and an awful lot of uncertainty. Again, it may not necessarily reflect the law as it stands, but the point is that it is not intended to; it is simply intended to show what the parameters of HMRC's challenge will be.

The Chair: That is a very good summation. Do any of the other panellists disagree?

Colin Ben-Nathan: I agree. It is also a lot to do with how the questions are answered, because, rightly and understandably, HMRC will stand by the CEST results only if the questions have been answered in accordance with the guidance. That is very important, because we are all very busy, particularly the people who are using CEST, and they do not necessarily pick up all the nuances in the guidance. More generally, I agree that it serves a purpose, but, as Stephen is saying, 20% of the time it is unable to determine. The question then is what you do next. I suppose if you do not have recourse to advice, you call the HMRC helpline, but there is a limit to what they can do because they are unlikely to want to look through all the contracts that you have and air all the particulars.

Alice Jeffries: Our members do find it very helpful that HMRC will allow you to rely on the outcomes of CEST, but it has three conditions to it. As has been said, they are sensible conditions. They are that the information you entered is accurate, that it remains accurate, and that it is used in accordance with HMRC guidance.

That second point is one that business would like a bit more guidance on from HMRC. How often are they required to review their existing contracts and check it remains accurate? On the third point, where HMRC guidance and case law are not in alignment, either because HMRC's view on something does not align with case law or because it has not been updated—the guidance tends not to be updated on a particularly regular basis for case law outcomes—businesses are left in the position where they are told that if they take this to court they will get one outcome, but HMRC is saying that it can rely on another outcome. Those gaps are also

quite important. I know we will talk about mutuality of obligation later, but business would like to see some of those gaps closed with more thorough guidance, particularly on the case law.

Meredith McCammond: Non-experts need a tool like CEST. To the extent that it is a starting point, that is fair enough. It does have limitations, and if you are talking about a complex case or a case that is on the borderline, you will need to get a second opinion. But, as I alluded to earlier, there are lots of cases that are not on the borderline and are not complex. In those cases, CEST can be very useful. I think we need to be very careful about CEST bashing, because CEST is used in lots of other kinds of context, not just IR35. It is very useful for workers, for example, who might be put into false self-employment. It would be a real shame if people were put off using CEST in a situation where it could otherwise benefit them.

The Chair: That is a very good point that comes back to your very first point, Stephen, in the sense that it is the outcome and the purpose of CEST that one needs to focus on here, and whether it is a tool for guidance or something more than that. We heard from the previous panel that contractors were getting letters from HMRC saying, "You might have had this in the CEST and now we might be questioning it". I do not know if you are picking that up, but is there a danger that we are seeing mission creep here, or maybe that the exact overriding purpose was never clear? Is that your sense about CEST: that we need something but it is just a guide, nothing more?

Stephen Ratcliffe: We need something and it is a guide. It is more than a guide; it is a guide to which HMRC has said it will adhere, provided that the preconditions are satisfied. In that respect, it is extremely helpful in identifying cases HMRC will not challenge, at least in theory.

The reality, however, is that there has already been one very widely publicised case involving the DWP and the use of CEST, no doubt with the best of intentions, in circumstances in which HMRC has none the less challenged and levied what I believe was a £4 million bill because CEST was not used accurately. As has already been said, without relatively detailed knowledge of the guidance that sits alongside CEST—in fact, arguably even with the benefit of that guidance—there is a danger that reliance cannot wholly be placed on it because of the opportunity for HMRC to say, "You did not quite answer that question correctly". Notwithstanding the purpose of it, which is to give certainty and to avoid the need for professional advice, there is still unfortunately a degree of uncertainty, even for those who use it.

The Chair: Very good. We move on to Baroness Kramer to talk about mutuality of obligation. Then I might come back on other aspects of CEST.

Q26 **Baroness Kramer:** Absolutely, yes. I knew we would get there. Mr Ratcliffe, with your employment law experience, perhaps you can help us with the mutuality of obligation issue. We are all aware that HMRC takes

the view that its position on the mutuality of obligation has been upheld in the recent opinion of the Court of Appeal: in other words, that just the simple existence of an employment contract determines that there is proof of mutuality of obligation and therefore that there is no need to include the issue in the CEST tool or to explore that any further.

We heard from the previous panel that that interpretation is subject to question, and indeed that the Court of Appeal has referred the case back to the First-tier Tribunal. What are your views on mutuality of obligation and the significance of the opinion from the Court of Appeal?

Stephen Ratcliffe: I should say that I have had the opportunity to discuss this today with the other members of the Legislative and Policy Committee of the ELA, so I am happy to say that this is not just my opinion. HMRC is right up to a point, but it is wrong, in our view, that mutuality is not included in the CEST test if CEST is intended to be reasonably close to the case law.

If you will permit the 30-second version of why mutuality is important, I should just explain that. The Ready Mixed Concrete case from 1968, which I mentioned earlier, sets out effectively three conditions to employment. The first irreducible minimum is mutuality of obligation. The second is control or subordination. The third is that other factors need to be consistent with employment. Mutuality is only one factor and it is not in itself determinative.

The other important point when we are framing the Court of Appeal's decision is that it distinguishes between, on the one hand, the existence of an overarching or umbrella contract of employment involving lots of different engagements, and, on the other hand, the existence of an employment contract in respect of each individual engagement. That is important, because a lot of the case law focuses on the former of the two, the overarching contract. That is because employment lawyers like me are typically interested in a long-term contract, because a lot of employment rights are linked to service. If you have an employment contract for one day, you do not get rights to unfair dismissal protection or redundancy pay, for example, whereas if you have a contract for two years you do. That is why a lot of the case law focuses on that overarching contract.

The Professional Game Match Officials case deals with that delineation and makes that point clearly. There is a difference between the existence of mutuality so as to find an overarching employment contract and mutuality sufficient to have an employment contract for that one engagement, which could be one day. Lady Justice Laing says that in the context of the one day, the one engagement, all mutuality requires is an agreement: "If I do X work, you will pay me Y pay". It does not even require that I am compelled to do that work. If I have a contract that allows me to back out of it before the work is done, even that could be enough mutuality to form an employment contract in respect of that one engagement or that one day.

That is important, because a lot of people who use CEST, a lot of people who use contractors, focus on whether there is an ongoing obligation of mutuality. I have an obligation to accept the work that is offered, or if I am the end user I have an obligation to give the work. That is as far as I would agree with HMRC. That decision stands for the proposition that, insofar as there is an agreement that work will be done and pay will be given in respect of it, that is sufficient mutuality to form the basis potentially of an employment contract for that one day.

Unfortunately, in arguing that mutuality need not be included in CEST or need not be included in a determination, HMRC is ignoring two equally important Court of Appeal cases from recent years, one called Quashie and another called Windle. In both those cases, the Court of Appeal makes the same distinction between the overarching employment contract and the individual engagement-type employment contract, but in both those cases it says that the absence of an ongoing obligation to accept work or the absence of an ongoing obligation to offer work may not itself be determinative of mutuality in that individual engagement case, but it is none the less relevant to the second of the conditions of employment, which is control.

What the Court of Appeal has said twice prior to this decision, and this decision does not conflict with this, is that the fact that there is no ongoing obligation of mutuality—ie an ongoing obligation to offer work and an ongoing obligation to accept the work and do the work that is offered—could still be relevant to the determination of whether an employment contract exists for that single engagement. Therefore, the Court of Appeal says that mutuality is still relevant to the determination of whether somebody is an employee, even if it is not relevant in the same way as it would be for an umbrella contract to the determination of whether there is mutuality in an individual engagement.

I apologise for an extremely long and complex explanation of what is a relatively simple point, but the takeaway is that HMRC is arguing that mutuality need not be covered by CEST, when the Court of Appeal has said twice it should be.

Baroness Kramer: That is extremely helpful, thank you.

Q27 **The Chair:** Sorry to dwell on CEST, but given that masterful summary of where we are, for a layman, can you explain or give us some ideas on how we can resolve the confusion about CEST in terms of its status and the outcomes in this large number of undetermined cases? You may have heard the previous panel say that there was a suggestion that there are lots of good sources of advice, including other tools, out there. Maybe those could be used. Maybe HMRC should take a step back and be less controlling. Meredith made the good point that there is a role for a tool, but does it have to be HMRC's? Can you think of a practical solution to the problems we face?

Colin Ben-Nathan: It is extremely difficult, because we do not have a codification for employment tax purposes of what we mean by

employment. A line in ITEPA, the main Act, says simply that employment includes employment under contracts of service. As was mentioned in the previous session, Matthew Taylor suggested a codification, which the Government said they would look at. They even said that they would look at employment taxes and employment law and see whether they could be aligned, but until there is some sort of codification I think we are trying to nail blancmange to a wall, in many ways.

I believe that was successful with regard to another intractable, or apparently intractable, problem that we had up to 2013, which was how we define tax residence. We had a whole lot of case law for a couple of hundred years, and in the end we codified it. Is it perfect? No, but is it arguably better than it was? I would say that it is.

The Chair: That is very useful. Meredith or Alice, do you have any comments on that?

Meredith McCammond: I agree with Colin. The employment status tests are incredibly complex, even for judges, as we have seen in the court cases that we have been speaking about. It was quite an odd decision to roll out the off-payroll rules while the whole ground underneath was so shaky. It is high time for a clearer and simpler employment status landscape for both businesses and workers to navigate. To that end, it is very disappointing that we have not seen any response yet from HMRC on the employment status consultation. That closed in 2018. A lot of stakeholders spent a lot of time and effort putting forward ideas and so on. As far as I can see from having checked just today, it is still analysing feedback. It would be very good to make some progress on that.

The Chair: Very good. That is a very practical point. Stephen, is there anything else you would like to add after your summary of the judgment?

Stephen Ratcliffe: I would simply reiterate my point that the gap in CEST is the challenge that most clients have. Also, I am sorry to be the one on this panel who is perhaps against the idea of codification, but I think that codification has not moved on because it is nigh on impossible. That is because there is no defined concept anywhere in the world of what employment is and what it is not, not in the really concrete way of "I can definitely put each case into one category or the other".

The notion of what is employment, what is waged work, what is a master and servant relationship is an ever-developing one, if you go back to case law from 200 years ago. Every time somebody develops a new app there is a different interpretation of employment. The problem is that we are seeking, as you say, to nail blancmange to a wall, but not just a wall, a moving wall. In my view, that is why codification is simply not realistic, unless there is a more fundamental change in the way in which the law determines who is an employee and who is not.

The law essentially determines employment by reference to three factors: mutuality, which we covered; control; and financial risk, integration and

all those sorts of things. Each of those could be argued to multiple levels of appeal by clever lawyers. You would need a much simpler test for determining what is employment and what is not, akin to any time a human being works for a company in any context—that is employment—in order to have codification.

Colin Ben-Nathan: The intellectual issue for me is that if you cannot codify what you mean by employment, you will be condemned forever to form judgments on various different shades of grey. That is the challenge, and I suspect we would probably all agree on that.

The Chair: Very interesting.

Q28 **Baroness Noakes:** I want to develop something that came up a bit earlier, I think when Ms Jeffries was talking about what impact the rules are having, and to get your views from your different perspectives on the impact that the new rules are having on the supply of labour, on the costs that contractors are charging or are being received, and on whether there are any particular sectoral impacts. We will start with Ms Jeffries.

Alice Jeffries: There is obviously huge variation between sectors and different sizes of businesses in the impact of that. The general consensus among our members who are engagers is that this has had a negative impact on their access to the labour market, and to flexibility if they have decided for their own internal risk purposes that they are no longer able to employ people who would be off-payroll, and just access to and availability of labour across the board. We talked about this in the previous session, but the departure of contractors from the labour market, whether that is through retirement or moving to other locations, has been a big issue.

There have been issues, as I mentioned before, with larger businesses suffering distortion in the market, where they have smaller competitors who do not have to apply the IR35 rules, so all their contractors are rushing to take those jobs rather than looking at the ones that are being offered to them, which have this additional complexity added to them.

The additional compliance burden shifts the cost-benefit analysis for contractors for shorter-term contracts, so flexible working over a shorter term has been significantly affected, more so than longer-term contracts and projects. If you have to go through a three-month process to work out whether you will be correctly employed by a business to take on a three-month contract, that is not worth it from the perspective of the contractor and often not for the business either.

Those are some of the key impacts that they are seeing, but they are largely negative in terms of access to the labour market.

Baroness Noakes: You said that there were different impacts in different sectors. Are there any particular sectors that you would draw to our attention?

Alice Jeffries: The key ones that I mentioned before—IT, defence, logistics and construction—were most commonly using contractors before this all started. They were also all businesses that were significantly impacted by other pressures on the labour market. They were affected by Brexit and by Covid, because to a large extent they were using non-UK individuals across the board, and many of them have gone home.

We talked about eastern Europe earlier. It is not just the high-skilled labourers who have gone back to eastern Europe. It is also the logistics drivers, not to say that they are not high-skilled. A lot of the construction industry members who were working in the UK came from eastern Europe and went home because of the combination of the pandemic and Brexit. They were already seeing pressures there, and those were exacerbated by the introduction of these rules.

Baroness Noakes: If we look at it from the other end of the telescope, from a LITRG perspective, what would your take be on the impacts on the labour market, rates and sectors?

Meredith McCammond: We have definitely seen a reduction in limited companies. That is without a doubt, and I think there are various motivations for that in the IR35 context. There are the workers who do not particularly want to be deemed employees, so they want to move abroad or retire or work for an umbrella. Then, of course, there are the businesses that want to swerve having to deal with the rules, costs, obligations and so on.

What I would say from a LITRG perspective is just to be a bit cautious about drawing too many conclusions at this stage about the specific impacts of the new IR35 rules on the labour market, because over the pandemic one of the main topics that we were written to about was the lack of support that limited company directors got under the Covid schemes. People were not entitled to any SEISS grants where they thought they were, and they were not entitled to very much under the job retention scheme, which came as a huge shock to them. That will have shaken the marketplace quite significantly, and I think that as a consequence of those pressures people have moved out of limited companies. A bit more research probably needs to be done before we can draw any firm conclusions.

Q29 **Baroness Noakes:** Can I move to another question for LITRG, which is about umbrella companies? You have told us that you had concerns that the off-payroll working rules would lead to more contractors going into umbrella companies, which would then push them more into non-compliant ones. Have you seen any evidence of that happening yet?

Meredith McCammond: That is a very good question. LITRG has always had a steady trickle of queries from workers in umbrellas with various grumbles or displaying some confusion and so on. That trickle has kind of subsisted. We have not seen any particular spikes in queries from workers about umbrella companies. We have not seen any trends presenting to us. As the kind of person who travels hopefully, what I

want to read into that is that workers have managed to navigate themselves successfully into an umbrella safe harbour. I think that is plausible, because an awful lot of work has been done on the KID initiative, the key information document initiative, which was kind of intended to bring transparency to the umbrella market.

As I mentioned before, HMRC has developed all these kinds of products and guidance about umbrella companies, and LITRG, as well as lots of people in the umbrella sector, has spent an awful lot of time in the last year trying to raise awareness about where the problems with umbrellas are. I would like to think that most contractors, if they have moved into umbrellas, have moved into safe umbrellas. I do think there will be some in non-compliant umbrellas. The thing with non-compliant umbrellas is that often it can take a while for the problems to surface, so we might not see exactly what kind of things they are grappling with until a bit further down the line.

Q30 **Baroness Noakes:** On umbrellas generally, do you think that HMRC does enough to warn about the potential dangers lying in wait for people in umbrella companies, mainly non-compliant umbrella companies? I think you will be aware of the call for evidence that was issued last week. Do you have any comments on that? We will start with Meredith again and then see if other people want to add anything.

Meredith McCammond: Umbrellas get very bad press. The LITRG report that we issued earlier this year showed that there are some very good umbrellas out there and that there is a lot of very good practice. The whole industry is very confusing for workers, particularly low-income workers. Doing more to help them understand how umbrellas work is very beneficial. I mentioned earlier the HMRC guidance on umbrellas. That was accompanied by a tool that will help workers understand whether or not they are paid via disguised remuneration. It included a payslip checker to help workers understand how to interpret their payslips.

I do think that HMRC is trying very hard in the umbrella space. I think the call for evidence was very positive. We were very pleased to see that and we were very gratified that our report seems to have helped prompt that movement. The key thing that we would like to see is HMRC trying very hard to get workers to write to it with their experiences, so that it has first-hand evidence of the problems with non-compliant umbrellas, because, as I alluded to earlier, there is a lot of hyperbole and a lot of drama about umbrellas.

What is required in order to tackle non-compliant umbrellas is a proper understanding of the problems, not just assumptions and drama and intrigue. Let us hope that there are some good responses to the call for evidence from workers, and let us hope that HMRC really use the responses to inform how it will move forward with umbrellas.

Baroness Noakes: Great, thank you. Any other comments on umbrellas?

Colin Ben-Nathan: I agree with Meredith. The call for evidence in relation to umbrellas is a good thing. I think it is a question of focusing on the bad apples. I also think that publicity will be very important so that workers are aware of where their pay may not be being calculated correctly, because they just do not realise a lot of the time. Maybe more can be done on the wider message, communication and media, and maybe something can be said on payslips for people who are in umbrella companies, because we know that there is a "check your payslip" facility on HMRC's website. We know about it, but maybe we just need to join the dots for others. That is what I would say: focus.

Q31 **The Chair:** In our previous panel, one got the sense—and I think one of our witnesses said—that the changes to IR35 are driving up tax avoidance. In a previous discussion with that panel it was said that the bad companies will drive out the good, or have the potential to do so. How do you do see that characterisation and forecast of what might happen? Meredith, I hear what you are saying—that not all umbrella companies are bad and that one needs to avoid that characterisation—but how do you see what I have just set out? Do you think that is plausible?

Meredith McCammond: I think there are a lot of workers out there who are a bit disgruntled about their reduction in net pay as a consequence of the changes, and some umbrellas will have entered the marketplace with their eye firmly on that gap in the market. As a consequence of that, disguised remuneration schemes have proliferated. There is the direct impact of disguised remuneration in terms of workers making an active choice to enter into them to keep their net pay up, but then there is an indirect knock-on effect, which is that if umbrella companies are running disguised remuneration, that affects not just ex-PSC contractors who want to keep their net pay up, but all workers who are then run through that umbrella, because the umbrella has worked out that it can make a quick buck and HMRC will not tackle it. It is not doing anything really at source to stop DR schemes, so lower-income workers get caught up in DR and the whole tax avoidance cycle extends and widens. It is not just about people who have an avoidance motive. It widens and becomes about people who do not have an avoidance motive that just get caught up in it as well.

Colin Ben-Nathan: I am not quite sure I see that the introduction of the off-payroll working rules will somehow inevitably promote an increase in avoidance. I certainly think it is important that we and HMRC are all alert to whether, if you push down one bump, then another bump comes up somewhere else. I can see that, but I would be surprised if there should somehow be some deterministic link between off-payroll working and an increase in avoidance. I do not recognise that.

Stephen Ratcliffe: I completely agree. I was very surprised to hear that evidence. The suggestion that what is admittedly a second attempt to close a tax loophole should itself lead to greater tax avoidance is questionable.

The Chair: Just explain why you think it is questionable. It is interesting.

It is emphatically the case that, as you rightly say, you want to maximise your take-home pay, so you go into an umbrella company that for whatever reason you do not understand is non-compliant. It is plausible, is it not?

Stephen Ratcliffe: That looks at one side of the equation only. I completely hear Meredith's point that it is not just the low paid who struggle to understand. I think even high-paid contractors might struggle to understand quite what is going on under the bonnet of some umbrella companies. That must be very difficult for those concerned. However, the other side of the equation is the clients who are using those umbrella companies. There has been a significant increase in the degree to which end clients are themselves auditing, or at the very least seeking to look under the bonnet of quite what sort of engagement is being used further down the supply chain. I have seen contractors with master providers that require the master provider effectively to guarantee that all umbrella companies are onshore and are putting people through payroll entirely correctly, and that no tax avoidance or tax evasion is going on further down the supply chain.

The Chair: Is that becoming the norm?

Stephen Ratcliffe: Yes, it is, or it should be, because HMRC expects clients to do that. It has long expected clients to do that in the agency sector and the temp agency sector. This is simply an extension of that.

Baroness Kramer: I wanted to come in on that one point. because in the example we were given the argument was that the non-compliant umbrellas are excellent at producing a piece of paper that provides all the guarantees that you have just listed. It is their sales pitch, and you can almost pick out a compliant company, because it does not provide this comprehensive list of reassurances. I think the argument was that it is not just in the abstract of IR35 and its remedies, but in an environment where you have a significant increase with the health and social care levy. But the differential now between what a non-compliant umbrella company will offer a worker versus what a compliant company will offer a worker has become very wide.

Stephen Ratcliffe: Yes. Quite honestly, I have seen one of those letters. I have seen a letter from a barrister saying, "As long as you pay tax somewhere in the world, it cannot be tax evasion". If that sort of thing is floating around, then yes, that is a trap for the unwary, but it is an easy one for HMRC to fix by saying, "Look, if this is the day rate, you cannot possibly come away with more than this if everything is being done correctly". Furthermore, clients who are using umbrella companies would be well-advised to think ahead, because we know that the single enforcement body will be policing this area. We do not know quite how or what it will target, but I live in hope that it will target the real bad actors, as opposed to just going door to door with the big name companies using umbrella companies and trying to pick off errors. I truly hope that it will go after the obvious bad actors who are selling something that is simply not true.

Alice Jeffries: I echo the point from engagers in businesses about supply chain compliance. The system now clearly—the latest guidance is from October of this year—puts the onus on the engager to look at its supply chain and ensure it is reasonably audited. If it is a large company, it will have a tax team and in most cases an auditor, whose job is to look at these processes. We also know anecdotally, and this was mentioned in the last session, that they are receiving letters from HMRC asking them how those processes work. It has targeted particular sectors, starting with oil and gas and financial services, but people across the board are getting requests to see how the processes work so that HMRC can ensure that they are compliant when it is looking down the supply chain.

Business would like a bit more clarity on how far down the supply chain they are supposed to look, but in the absence of that the risk-averse businesses are looking as far as they can go. They are hitting commercial blockers when they are asked to do things like look at payslips. Agencies are unwilling to provide payslips, which would show the level of mark-up that an agency is providing, so they are hitting commercial blockers there, but they are doing that work. Those kinds of businesses will not be fobbed off with a letter from a barrister that has been given as a part of the marketing materials to an individual worker saying, "It's not tax evasion, because you have paid some tax in X jurisdiction", so that process is happening from the other end.

The Chair: Very interesting. Unless anyone has any further final questions, thank you all very much for an incredibly useful session, and thank you for your written evidence as well.