



HM Revenue
& Customs



HM Treasury

The Government Response to the report from the Economic Affairs Finance Bill Sub-Committee on off-payroll working

Introduction

1. The Government would like to thank the House of Lords Economic Affairs Finance Bill Sub-Committee for their inquiry into the off-payroll working rules. The off-payroll working rules are designed to ensure that people working like employees but through their own companies, and their engagers, pay broadly the same income tax and national insurance contributions as people who are directly employed. The Government firmly believes that reforming the rules and transferring the responsibility for determining whether they apply from individual contractors to the firms that engage them will be a step towards greater fairness in the tax system.
2. It is estimated that non-compliance with the off-payroll working rules will cost the Exchequer £1.3 billion per year by 2023/24. The reform protects the tax base, and therefore revenue needed for vital public services, but importantly it also ensures fair tax treatment of individuals across the labour market. Employment status for tax is determined on a case-by-case basis through consideration of the actual working practices of an individual and the applicable case law. This is how status is decided for the vast majority of individuals, including employees and self-employed sole traders. It is widely accepted that the rules introduced in 2000 have not been effective and there is widespread non-compliance. The changes to the rules, in 2017 in the public sector and from April 2021 in the private and voluntary sectors, will ensure that these principles apply equally to those working like employees but through a limited company.
3. The Government agrees with the Sub-Committee that contractors and the skills and flexibility they offer are an important part of the UK labour market. However, it does not agree that all contractors are therefore in a different category to employees. In cases where all the tests of an employment relationship are met, it is not right that the use of a limited company structure should result in the paying of significantly less tax than a direct employee doing the same job.
4. Officials from HMRC and HMT gave evidence to the Sub-Committee on Monday 16 March. Shortly after these sessions, on 17 March, a delay to the reform from April 2020 to April 2021 was announced as part of the Government's support for those impacted by COVID-19. The Financial Secretary to the Treasury was also due to give evidence to the Sub-Committee, but this was unfortunately cancelled due to the pandemic.
5. The Government agrees with the Sub-Committee that it is important to use this additional time ahead of implementation wisely, and this response sets out how it intends to do that. In this document the Government is responding to the main recommendations of the report, which have been grouped into eight broad categories.

Delay in announcing the introduction of the reform in April 2021 until October 2020, when COVID-19 impacts may be clearer.

6. As the Sub-Committee notes in their report, the Government had planned to extend the off-payroll working rules to the private and voluntary sectors in April 2020. Following the COVID-19 outbreak, the Government decided that introducing the new rules would be inappropriate at an extremely difficult time for the economy. The Sub-Committee welcomes this delay in their report and agrees with the Government that it is right not to impose additional burdens on business at such a difficult time. However, the Sub-Committee suggests that the Government should wait until October 2020 to announce whether it will implement the off-payroll working rules in April 2021. The Government has been clear that it is committed to introducing the reform with an implementation date of 6 April 2021.
7. At the time of the delay, many businesses would have been prepared for this change to take place. It is vital, in the current conditions, that businesses and stakeholders have clarity over the timing of the implementation of the reform, and the final legislation, so that they can prepare in a timely fashion. Waiting until October to confirm whether it will be implemented would create uncertainty.
8. Indeed, any additional delay would have significant drawbacks; it would not address the fundamental unfairness of taxing two people differently for the same work, and it would further prolong the disparity between the private and voluntary sectors and the public sector, where the rules have been in place since 2017. There is a risk that this continuing disparity could begin to cause retention difficulties in the public sector, as contractors may choose to accept only private sector contracts, as well as being unfair to contractors working in the public sector.
9. The Government also recognises that shifting the responsibility to employers for determining whether the off-payroll working rules apply is a significant change. As such, HMRC has been working collaboratively with businesses and has committed to adopting a 'light touch' approach to compliance penalties in the first twelve months of the reform.
10. The Government agrees with the Sub-Committee that it should use the extra time afforded by the delay productively. For this reason, the Government will be taking a number of steps over the next year to ensure it does so, which are set out in the relevant sections of this response.

Employment Rights

11. The Sub-Committee recommends that the Government carries forward work on the Taylor Review, to develop legislation which is responsive to the changing labour market.
12. The previous Government's response to the Taylor review was published in February 2018, alongside a series of consultations, including one on how to improve clarity and certainty on employment status for businesses and individuals. Following this period of consultation, the previous Government then published the Good Work Plan in December 2018.
13. Since the publication of the Good Work Plan the Government has made good progress in taking forward a number of actions to deliver on the Taylor Review. These include the following measures:
 - Extending the right to a written statement of core terms of employment to all workers; making access to a written statement a day one right and extending the contents of a written statement.
 - Quadrupling the maximum fine for employers who treat their workers badly.
 - Making it easier for workforces to request information and consultation arrangements by lowering the threshold for a valid request from 10% to 2% of the workforce.

- Closing a loophole which sees agency workers employed on cheaper rates than permanent workers.
 - Introducing a right for agency workers to receive a key facts page when signing with a company.
 - Reforming rules to help align the incentives of employers and workers when applying for and taking annual leave.
14. The increase in the maximum fine came into force in April 2019, and the remainder of these changes took effect on 6 April 2020.
15. In addition, the recent Queen’s Speech committed to bring forward an Employment Bill to promote fairness in the workplace. The Government will continue to work across departments on these issues and will respond to the 2018 employment status consultation in due course. Given the complexity and importance of labour market policy, it is clear that careful deliberation is essential before considering any future reforms. However, the unfairness of contractors paying less tax than employees when their engagement meets the test of an employment relationship, and the resulting loss of revenue needed for important public services, is a long-standing problem that the Government cannot delay addressing any further.

Independent review into the implementation of the public sector reform

16. The Government agrees with the Sub-Committee on the need to give adequate scrutiny to the legislation at each stage of the process and has consulted extensively on the reforms to the off-payroll working rules. Throughout the consultation and review processes the Government has made a number of changes in response to stakeholder feedback. Specifically, the Government has carried out four consultations since 2015 looking carefully at how the rules could be improved, and considered a range of options on how to achieve this, many of which are raised by the Sub-Committee. These alternative options are discussed in more detail later in this document. In January 2020, the Government carried out a review of the implementation of the upcoming reform, publishing its report and conclusions on 27 February, and can be found at: <http://www.gov.uk/government/publications/review-of-changes-to-the-off-payroll-working-rules-report-and-conclusions>.
17. The Sub-Committee recommends that the Government should undertake an independent review of the implementation of the reform to the off-payroll working rules in the public sector and an analysis of the impact of the reform on the labour market. Soon after the reform was introduced in the public sector in 2017, the Government commissioned independent research to assess how the reform had been implemented and its effect on the labour market. Independent researchers found that there was no significant disruption to the sector or its use of contingent labour as a result of the off-payroll reforms.
18. The Government agrees with the Sub-Committee on the need to ensure the long-term flexibility and success of the labour market and has already committed to commissioning further independent research into the long-term effects of the 2017 reform on the public sector.
19. The Government intends to make that research available before the reform comes into effect in all other sectors in April 2021. The Government will give careful consideration to the results. As with all areas of tax policy, if the research suggests that there are any implementation difficulties or any areas where further support is necessary, the Government will consider further action to address

these concerns. This sits alongside the ongoing work HMRC are doing to evaluate and enhance its education and support offer ahead of implementation in April 2021, which is outlined below.

Market Impacts and Blanket Assessments

20. The Sub-Committee expressed concerns about the effect of the upcoming reform on the UK labour market. Whilst the reform affects a small proportion of the labour market (approximately 170,000 individuals are estimated to be in scope of the reform, compared to around 33 million people in employment between January and March 2020), contractors are an important part of the UK's workforce. The Government acknowledges that, as a result of the changes to the off-payroll working rules, some organisations are taking the opportunity to consider whether personal service companies are the best way of engaging individuals who are working like employees. This is a business decision about the most effective way to structure their workforces. It is important to also note that these commercial decisions are driven by a wide range of factors, such as changes in technology, markets and wider business and labour market practices, and will not be made purely for tax reasons. However, as was the experience in the public sector, this does not suggest that there is an overall reduction in the demand for the skills and services contractors offer as a result of these changes.
21. The Government has already committed to conduct independent research on the impacts of the reform in the private sector six months after implementation. The Sub-Committee noted that this would not give enough time for the full impact of the reforms to become apparent and recommended that HMRC defer this research until 18 months after the rules have been in operation. It is important that research is carried out promptly, to provide an early understanding about how the reform is bedding in. However, the Government agrees that it is important to continue monitoring the impact of the reform over time and will consider how best to do this.
22. The Sub-Committee also raised concerns about blanket determinations, with the concern that organisations will determine all contractors to be 'inside IR35' regardless of their contractual and actual working arrangements. A blanket determination would occur if an organisation categorises all engagements with PSCs as subject to the off-payroll working rules and thus deducts employment taxes, regardless of the facts of the working relationship. However, this is different from organisations deciding not to engage with PSCs, which does not equate to a "blanket determination" as organisations are free to decide how to structure their workforces and how to engage workers.
23. The Government is clear that end-clients must take reasonable care when making status determinations for off-payroll working and making blanket determinations is not compliant with the rules. Engagement with organisations as part of the February 2020 review of implementation found that the vast majority had put in place processes to ensure accurate status assessments. Nevertheless, the Government recognises concerns about the possibility of incorrect status determinations occurring, and when designing its future education offer, HMRC will consider whether there is any additional support that can be offered to ensure organisations approach status assessments correctly.

Education and Support, including the Check Employment Status for Tax (CEST) tool

24. The Government notes the report's conclusion that the requirement to determine a contractor's employment status for tax imposes a burden on businesses, with support offered by HMRC falling

short of what is required. The Sub-Committee also expressed concern about the complexity of the 'IR35 test'.

25. It is worth clarifying that the off-payroll working rules use the existing employment status test set out in case law, which is applicable to all individuals. There is no unique test for off-payroll workers, and the reform to the off-payroll working rules does not change the longstanding test for employment status. In the vast majority of situations, employment status decisions are straightforward.
26. The Sub-Committee felt that HMRC should not 'outsource' the responsibility for ensuring status assessments are carried out accurately to businesses. However, this judgement rests on a misunderstanding. HMRC have at no point been responsible for status assessments. Rather, the responsibility is being moved up the supply chain from the contractor's personal service company (PSC) to the end-client. International evidence shows that having a trusted intermediary handle taxpayers' reporting and payment can lead to better compliance and lower tax gaps. It can also reduce the administrative burdens on individual taxpayers, making tax more straightforward for them. There are already many cases where businesses play a significant role in ensuring the tax that is owed is paid. In fact, this principle applies across the UK tax system - for example through the Pay As You Earn scheme and National insurance system. Providing incentives for organisations to ensure tax compliance in their supply chain can also help to tackle risks from promoters of tax avoidance.
27. The Government agrees with the Sub-Committee that organisations need help to prepare for the changes introduced by this reform. This is why HMRC created a dedicated team to provide education and support for businesses and individuals. In preparation for the reform, HMRC have so far completed nearly 950 1-2-1 calls with medium and large businesses, held 10 webinars and issued 59,500 letters to customers explaining the changes to the rules. This team is currently conducting a comprehensive evaluation of the education and support package offered during 2019/20, including collating feedback directly from organisations. The extra time afforded by the delay will be used to complete this evaluation. This will be used to inform the design of an enhanced programme of targeted support ahead of April 2021.
28. The Government disagrees with the Sub-Committee's view that the CEST tool is not fit for purpose. HMRC have invested a significant amount of time and resources into developing CEST as a free-to-use online service which helps customers determine the employment status of an individual, based on the facts of the engagement. As the Sub-Committee acknowledged, HMRC have made significant enhancements to CEST since it was first introduced in 2017. The current CEST tool was rigorously tested against employment status case law. Details of this technical testing were published by HMRC on 17 March 2020 and can be found at: <https://www.gov.uk/government/publications/check-employment-status-for-tax-cest-2019-enhancement>.
29. These enhancements were positively received by stakeholders at the time, which was echoed at stakeholder roundtable events in January 2020 and in evidence provided to the Sub-Committee. When the CEST tool was compared with other commercial tools it was found to give equivalent results. However, as was recognised by witnesses giving evidence, no tool could be developed to cover every single judgment on employment status.
30. The Sub-Committee is correct that CEST has provided a determination in approximately 80% of cases since the enhancements were made. However, in recent months, HMRC have seen a significant increase in this percentage. Provided the information submitted is accurate and in accordance with the guidance, HMRC consider a determination from CEST to be definitive, with no further

considerations required. This is in contrast to commercially available tools that often provide a risk-based or qualified determination.

31. Where the CEST tool is not able to provide a determination, HMRC have produced specific guidance to help users in completing the tool. This explains why the tool asks for certain information, gives a fuller explanation of the questions and uses examples to demonstrate which box should be selected in each situation. In addition, there is wider guidance available on GOV.UK and in HMRC's Employment Status Manual on the principles of employment status. This guidance is intended to provide individuals with an understanding of the underlying tax rules needed to make a determination. Should a user need further assistance in completing the CEST tool, they are also able to call a dedicated HMRC helpdesk.
32. The Government is committed to continuous improvement of customers' experiences of CEST. Since the launch of the CEST enhancement in November 2019, HMRC conducted a series of internal assessments looking at the operation of the tool's underlying systems and improvements to its usability. The review found that some customers experienced difficulties in understanding what steps to take if they received an "unable to determine" outcome. As a result, HMRC are actively considering what more can be done to support customers; for example, through in-tool updates or guidance changes.
33. HMRC are also exploring a number of other changes to improve the usability of the service. Where possible, HMRC plan to engage stakeholders actively on any changes.

Potential cost to business of the new rules

34. As stated in written evidence given to the Sub-Committee by HMRC and HMT officials, the estimated administrative burden on businesses of implementing the reform is based on the estimated costs of undertaking a range of preparatory activities, including familiarisation, training and setting up of processes. Whilst the methodology incorporated some aspects of the Standard Cost Model, which is an internationally recognised approach of using a database of obligatory activities businesses need to undertake to comply with the tax system, this was adapted to reflect a wider range of costs for businesses.
35. The purpose of this estimate is to reflect the minimum preparations HMRC believe to be necessary for businesses to be compliant with the rules, recognising that some will wish to undertake a greater amount of preparation than others. For example, the Government heard during the review of the implementation of the reform that some businesses have used the reform as an opportunity to look at their wider workforce arrangements or make enhancements to their infrastructures and processes. Others may also have sought additional advice based on their specific circumstances. These additional costs are not costs of implementing the reform and, as such, will not be factored into HMRC's estimate of the administrative burden.
36. The Government has looked at the evidence submitted to the Sub-Committee and believes that it is right to ensure the costs incurred in preparing for the reform are fully understood. HMRC have already begun reviewing the estimated administrative burden on businesses of implementing the reform, as committed to during the inquiry. This review will test the assumptions used in the methodology, such as the average time taken for each change in burden, the proportion of engagers and end clients using an agent, and the review and setting up of new processes. HMRC will consider whether further burdens should be included in light of the evidence submitted to the Sub-Committee. HMRC are also looking at how to reduce some of the burdens on businesses. For

example, in order to reduce the time it takes for an end-client to respond to a request from a contractor to confirm their size, HMRC will publish a product that can be used, if they choose to.

37. As part of this review, HMRC will consult with the Administrative Burdens Advisory Board (ABAB). HMRC will publish the revised administrative burden costs at the next fiscal event in a revised Tax Information and Impact Note (TIIN).

Umbrella companies

38. The Government shares the Sub-Committee's concern about the potential growth in non-compliant umbrella companies in the labour supply market and is already acting upon the recommendation of the Sub-Committee, which calls on HMRC to engage more with businesses and tax professional bodies about the risks in this area.
39. As stated in the written evidence from the Financial Secretary to the Treasury, HMRC already recognise this non-compliance as a strategic risk. For this reason, HMRC are taking action to tackle this behaviour, working with the Advertising Standards Authority and other third parties to prevent the publication of misleading information by umbrella companies. HMRC are also working with the Employment Agency Standards Inspectorate to promote tax compliance in employment agencies and umbrella companies and to raise awareness of risks around tax avoidance among contractors and agency workers.
40. HMRC regularly specific communicate warnings to taxpayers via agents and expert bodies on the risks of engaging with non-compliant umbrella companies. For example, Spotlight 45, published in 2018, warned of "Umbrella companies offering to increase your take home pay" and more recently in Spotlight 54 of, "Tax avoidance promoters targeting returning NHS workers" as well as "Comparison and broker websites marketing umbrella companies are not always what they seem", in Spotlight 55.
41. Furthermore, the Government committed at the Budget in March 2020 to launch a call for evidence on tackling disguised remuneration tax avoidance. This will include a focus on the role of non-compliant agencies and umbrella companies and will explore further action to tackle this non-compliant behaviour.

Alternatives to the off-payroll working rules

42. The Government agrees with the Sub-Committee on the need to ensure greater fairness in the tax system and welcomes all efforts in that regard. The objective of the off-payroll working rules is to ensure that individuals who work through their own companies but who would have been employees if engaged directly, pay broadly the same amount of tax as an employee doing the same job.
43. The report offers a number of alternative approaches aimed at tackling non-compliance with the existing rules. During the extensive consultation process on the reforms, views were welcomed on alternative options for more fundamental reform. These alternative options, including many of those raised in the report, were considered fully as part of the process and the reasons for not pursuing these options were set out following each consultation. Further details can be found in the 2016 and 2018 consultation documents on the reform at:
 - Off-payroll working in the public sector: reform of the intermediaries legislation published 26 May 2016: <https://www.gov.uk/government/consultations/off-payroll-working-in-the-public-sector-reform-of-the-intermediaries-legislation>

- Off-payroll working in the private sector published 18 May 2018:
<https://www.gov.uk/government/consultations/off-payroll-working-in-the-private-sector>

44. In general, the approaches suggested would create a group that are exempt from the employment status tests and subject to a separate and advantageous tax regime, which was not considered to be fair to the majority of working individuals, who are subject to the existing boundary between employment and self-employment.
45. For example, the proposal for the creation of a new corporate structure, a “freelancer limited company”, which would allow the company to qualify for special tax treatment was rejected after reviewing the proposal in further detail. It would have effectively created a new tax regime with special treatment for a certain group of tax payers regardless of whether they are working like employees under existing employment status law, without addressing the key principle that individuals working in a similar way should pay a similar amount of tax.

Conclusion

46. The Government has carefully considered the Sub-Committee’s report into the off-payroll working rules. Whilst the Government is still committed to introducing the reform to these rules in this Finance Bill, with an implementation date of 6 April 2021, it agrees with the Sub-Committee that the delay should be used productively and effectively.
47. The Government has already committed to commissioning further research into the public sector reform to assess how the reform had been implemented and its effect on the labour market. Furthermore, HMRC are enhancing its education and support to businesses and individuals ahead of the implementation of the reform in April 2021. HMRC will continue to engage with a wide range of stakeholders on the implementation of the reform, working with different sectors to ensure businesses understand the changes.
48. The Government would again like to thank the House of Lords Economic Affairs Finance Bill Sub-Committee for their inquiry into the off-payroll working rules.