



Rt. Hon. Lucy Frazer QC MP  
Financial Secretary to the Treasury

9 February 2022

**By Email**

Dear Financial Secretary,

**Off-payroll working follow-up inquiry**

Thank you again for appearing before the Finance Bill Sub-Committee on 13 December 2021 to give evidence for our follow-up inquiry on off-payroll working.

As you know, the Sub-Committee also held two oral evidence sessions on 6 December 2021, when we took evidence from tax bodies and representative organisations. We received over 30 submissions of written evidence from relevant organisations and from individual contractors and engagers.<sup>1</sup> We are grateful to all those who gave written or oral evidence, and to officials at HM Treasury and HMRC for their assistance with our follow-up work.

This letter summarises our conclusions and recommendations (set out in bold). We would be grateful for a detailed response to this letter no later than **9 March 2022**.

**Background**

1. In April 2020, the Finance Bill Sub-Committee published its report *Off-payroll working: treating people fairly* on the Government's proposals for extending the off-payroll working rules to the private sector.<sup>2</sup> Under these proposals, the Government indicated its intention to move responsibility for assessing compliance with its off-payroll working rules from contractors to those who engage them. These changes were intended to extend reforms implemented in the public sector in 2017 to large and medium-sized businesses in the private sector.
2. The original proposals were initially included in the draft Finance Bill 2019, with a proposed commencement date of April 2020, but in March 2020 the Government announced that implementation would be deferred until April 2021.<sup>3</sup>
3. In its response to our 2020 report, the Government acknowledged the need to use the extra time resulting from the delay in implementation productively.<sup>4</sup> Following the introduction of these rules in April 2021, the Sub-Committee agreed to hold a short follow-up inquiry into their implementation, and how the rules are working in practice.

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<sup>1</sup> The term 'engagers' as used here refers to the business the contractor ultimately works for.

<sup>2</sup> Economic Affairs Committee, [Off-payroll working: treating people fairly](#) (1st Report, Session 2019-20, HL Paper 50)

<sup>3</sup> Economic Affairs Committee, [Off-payroll working: treating people fairly](#) (1st Report, Session 2019-20, HL Paper 50), para 139.

<sup>4</sup> HM Treasury, [The Government Response to the report from the Economic Affairs Finance Bill Sub-Committee on off-payroll working](#), 26 June 2020 [accessed 26 January 2022]

## Implementation and communication

4. In preparation for the new rules coming into force, HMRC told us it had provided “a detailed programme of education and support for customers affected by the change” including hosting 57 webinars and 30 workshops on the changes, contacting affected organisations directly (including through one-to-one telephone calls), as well as sector-specific activity and enhancing the information published on GOV.UK.<sup>5</sup>
5. The Sub-Committee found that the year’s grace and HMRC’s communication drive prior to the introduction of the new rules were generally welcomed by our witnesses. Colin Ben-Nathan of the Chartered Institute of Taxation (CIOT) said HMRC was “much better prepared” when compared with the implementation of the changes in the public sector in 2017 and “HMRC has done a lot on communication, upgrading the guidance and making modifications to the CEST [Check Employment Status for Tax] tool.”<sup>6</sup>
6. The Low Incomes Tax Reform Group (LITRG) commended HMRC for thinking creatively about how to reach people and tailor guidance for different audiences.<sup>7</sup> Meredith McCammond, Technical Officer of the LITRG, said that businesses were “not in the same kind of uncharted territory that they were in 2017”, noting that many were supported by agents who had already been through the earlier changes in respect of public sector clients.<sup>8</sup>
7. Other witnesses raised concerns about the overall level of preparedness on the part of businesses, however. Phil Pluck of the Freelancer and Contractor Services Association (FCSA) said that a survey conducted by his organisation just before implementation showed that 70 per cent of engagers had not prepared themselves to apply the new rules.<sup>9</sup> Alice Jeffries of the Confederation of British Industry (CBI) told us that it would have been helpful if HMRC had started its education campaign earlier, as it would have allowed time to address some of the more specific issues of concern to larger businesses.<sup>10</sup>
8. Written evidence from HMRC in December 2021 noted that it had commissioned external research into the implementation and short-term effects of the extension of the off-payroll rules in the private sector, but that fieldwork was not yet complete.<sup>11</sup> It is proposed to publish the findings during 2022. This research covers only engagers and is focussed on the administrative burden of the changes, the usefulness of the education and support provided, and the impact on the contractor workforce. We comment on other aspects of this research below.
9. **Changes to off-payroll rules are challenging for many businesses and workers, especially against the backdrop of the economic impact of COVID. The Sub-Committee welcomes the efforts HMRC has made to communicate these changes via multiple channels and the continuing support to businesses through implementation.**
10. **We welcome the fact that HMRC has also learned lessons from the roll-out of the off-payroll working rules in the public sector and that the department is conducting research into the short-term effects of the changes. We look forward to seeing the results of this research.**

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<sup>5</sup> Written evidence from HMRC ([OPR0036](#))

<sup>6</sup> [Q 17](#) (Colin Ben-Nathan)

<sup>7</sup> [Q 20](#) (Meredith McCammond)

<sup>8</sup> [Q 17](#) (Meredith McCammond)

<sup>9</sup> [Q 6](#) (Phil Pluck)

<sup>10</sup> [Q 19](#) (Alice Jeffries)

<sup>11</sup> Written evidence from HMRC ([OPR0036](#))

## The Check Employment Status for Tax tool (CEST)

11. At the time of the public sector reforms, HMRC introduced an online tool, Check Employment Status for Tax (CEST), which was intended to help public sector bodies assess the status of contractors. In our original inquiry, we heard a lot of criticism of CEST from witnesses, leading us to question whether it was fit for purpose given the limited assistance it appeared to offer to business.<sup>12</sup> The Government disagreed with our conclusion and told us that it was committed to “continuous improvement” of users’ experience of CEST and considering what more could be done to support users where, for example, they received an “unable to determine” outcome.<sup>13</sup> It has been reported that a number of Government departments have been charged material penalties for non-compliance with the rules, connected with how they have approached assessment of the status of contractors.<sup>14</sup>
12. Many of the original criticisms of CEST were repeated by witnesses in our follow-up inquiry. Martin McTague of the Federation of Small Businesses (FSB) said that CEST was still “not fit for purpose”.<sup>15</sup> Andrew Chamberlain of IPSE said that they did not believe that CEST came up with accurate summations of employment status.<sup>16</sup> Phil Pluck of the FCSA agreed, saying its view was that CEST was “probably only 50 per cent to 60 per cent accurate”.<sup>17</sup>
13. One witness highlighted the continued failure of CEST to include questions on mutuality of obligation. In its written evidence, HMRC referred to a recent Court of Appeal decision which it said agreed with its view on mutuality.<sup>18</sup> However, Stephen Ratcliffe of the Employment Lawyers Association (ELA) said it was wrong to exclude questions on mutuality “if CEST is intended to be reasonably close to case law”, given that mutuality of obligation, albeit not itself determinative, is the “first irreducible minimum” condition (of three) for there to be an employment relationship.<sup>19</sup> Other witnesses told us CEST was flawed unless mutuality was addressed.<sup>20</sup>
14. Pete Downing of HMRC subsequently told us that “the distance between [HMRC] and the evidence you have had on mutuality is rather less than you might think it is”.<sup>21</sup> He explained that, when considering adding questions to CEST, it was important to balance the impact on the usability of CEST against the number of additional determinations expected.<sup>22</sup>
15. HMRC’s statistics on CEST usage currently show that CEST produces a status determination in around 80 per cent of cases, with the remaining 20 per cent shown as “unable to determine”. In evidence to the Sub-Committee, you told us that HMRC decided that “in order for it to be easy to use, not be expensive and not take up too much of people’s time, [CEST] will deal with 80 per cent and not 100 per cent” of cases” and that producing an outcome in all cases would make it “quite complicated”.<sup>23</sup>

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<sup>12</sup> Economic Affairs Committee, *Off-payroll working: treating people fairly* (1st Report, Session 2019-20, HL Paper 50), para 87

<sup>13</sup> HMRC, ‘Government response to the report from the Economic Affairs Finance Bill Sub-Committee on off-payroll working’, <https://committees.parliament.uk/publications/1873/documents/18378/default/>, paras 28–33

<sup>14</sup> ‘What can we learn from public sector IR35 tax bills?’ *FT Advisor*, (29 September 2021): <https://www.ftadviser.com/companies/2021/09/29/what-can-we-learn-from-public-sector-ir35-tax-bills/> [Accessed 28 January 2022]

<sup>15</sup> [Q 8](#) (Andrew Chamberlain)

<sup>16</sup> [Q 8](#) (Phil Pluck)

<sup>17</sup> [Q 8](#) (Andrew Chamberlain, Phil Pluck, and Martin McTague)

<sup>18</sup> [Q 44](#) (Pete Downing); Written evidence from HMRC ([OPR0036](#))

<sup>19</sup> [Q 26](#) (Stephen Ratcliffe); the other conditions are “control” and other factors consistent with employment

<sup>20</sup> [Q 8](#) IPSE and FCSA

<sup>21</sup> [Q 44](#) (Pete Downing)

<sup>22</sup> [Q 44](#) (Pete Downing)

<sup>23</sup> [Q 43](#) (Financial Secretary to the Treasury)

16. Stephen Ratcliffe of the ELA described the number of “unable to determine” outcomes as a “gap in CEST” leading to uncertainty and cost for clients.<sup>24</sup> However, Meredith McCammond of the LITRG told us that a lot of cases that were not on the borderline and that, for non-experts, it was what was needed.<sup>25</sup>
17. The FSB said that receiving an “unable to determine” outcome “leaves individuals and small businesses without clear indication of whether they need to comply with the tax”.<sup>26</sup> Although where a user receives an “unable to determine” outcome, an HMRC helpline is available to answer queries, witnesses told us that “getting through to it is difficult”<sup>27</sup> and that in any event “there is a limit to what they can do”.<sup>28</sup> HMRC told us that it currently had 21 staff dealing with taxpayer queries on off-payroll working and employment status.<sup>29</sup> During 2021, the average number of calls to the helpline each month was around 2,700, but HMRC acknowledged that not everyone who got an “unable to determine” outcome would call.<sup>30</sup> Andrew Chamberlain said that “the reality for most people who come out as undetermined is that the client will decide that IR35 applies at that point”.<sup>31</sup>
18. We note that CEST’s ability to deliver an outcome (and the accuracy of that outcome) is important both for HMRC and taxpayers, given HMRC’s commitment to stand behind its results, subject to the information entered being accurate and CEST being used in accordance with HMRC guidance. Alice Jeffries of the CBI said that businesses found the ability to rely on CEST “very helpful” but noted that, where HMRC guidance and case law diverged, “businesses are left in the position where they are told if they take this to court they will get one outcome, but HMRC is saying that it can rely on another outcome”.<sup>32</sup>
19. Stephen Ratcliffe of the ELA said that “there has been confusion over what CEST is intended to achieve”, telling us that “it is not a codification of the law on employment status ... It is an indication of the cases that HMRC will not seek to challenge”<sup>33</sup> which he described as “extremely helpful”.<sup>34</sup> However, he pointed out that HMRC could still challenge cases where CEST had been used, referencing a recent £4m penalty for the Department for Work and Pensions.<sup>35</sup> Phil Pluck of the FCSA also saw CEST acting as a guidance tool but had concerns that recent compliance activity indicated that HMRC may be regarding it as more of a “legal requirement” as it appeared to be the only tool that HMRC would acknowledge.<sup>36</sup> Pete Downing of HMRC however said that “HMRC is not treating CEST as the only determinant of payroll status”.<sup>37</sup> He told us:

*“We come back to the fundamental purpose of CEST. CEST is a guidance tool ... It indicates where people have cases that we consider to be self-employed. As I understand it, that is of great value to*

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<sup>24</sup> [Q 25](#) (Stephen Ratcliffe)

<sup>25</sup> [Q 25](#) (Meredith McCammond)

<sup>26</sup> Written evidence from FSB ([OPR0026](#))

<sup>27</sup> [Q 8](#) (Andrew Chamberlain)

<sup>28</sup> [Q 25](#) (Colin Ben-Nathan)

<sup>29</sup> Written evidence from HMRC ([OPR0036](#))

<sup>30</sup> [Q 36](#) (Financial Secretary to the Treasury); According to HMRC CEST usage statistics, over 230,000 “unable to determine” outcomes were obtained in relation to off-payroll working between November 2019 and August 2021.

<sup>31</sup> [Q 8](#) (Andrew Chamberlain)

<sup>32</sup> [Q 25](#) (Alice Jeffries)

<sup>33</sup> [Q 25](#) (Stephen Ratcliffe)

<sup>34</sup> [Q 25](#) (Stephen Ratcliffe)

<sup>35</sup> [Q 25](#) (Stephen Ratcliffe)

<sup>36</sup> [Q 8](#) (Phil Pluck)

<sup>37</sup> [Q 44](#) (Pete Downing)

people. They answer 37 reasonably objective questions as opposed to engaging with the case law test

...<sup>38</sup>

20. Martin McTague of the FSB told us of an emerging “cottage industry” of people who had developed tools for answering CEST to achieve certain outcomes.<sup>39</sup> The FCSA noted that there were internet sites which offered a “detailed step by step guide” to answering questions in order to achieve a desired outcome.<sup>40</sup> You told us that the Government did not accept that CEST could be gamed to produce a particular answer, but that questions should be answered correctly and accurately.<sup>41</sup>
21. **The Sub-Committee believes it is critical CEST’s limits are clearly acknowledged by HMRC. It cannot and should not be a substitute for law. HMRC needs to ensure that, in its compliance work, it recognises that the use of other means to assess employment status is both legitimate and reasonable.**
22. **We acknowledge that CEST has been designed to be easy to use, and cannot be expected to cater for every possible scenario. However, a 20 per cent “undetermined” rate means a significant number of people need additional support to identify their status if the off-payroll working rules apply. We consider that more must be done to improve the advice and support available for those who receive a CEST “unable to determine” outcome.**
23. **The continued absence of questions on mutuality of obligation within CEST means that many of those impacted by the off-payroll working rules do not have confidence in the accuracy of its results. We recommend that HMRC work with stakeholders through the IR35 Forum to agree modifications to CEST to reflect the test of mutuality of obligation properly.**

#### **Status Determination**

24. In our 2020 report, we drew attention to two unwelcome developments triggered by the extension of the off-payroll rules. These were “blanket bans” by engagers (whereby the engager refuses to engage any contractor working through a PSC, thus avoiding having to apply the off-payroll rules) and blanket decisions (whereby an engager determines that all contractors it engages in a particular area are regarded as within the off-payroll rules, without looking individually at the circumstances and facts of each appointment).<sup>42</sup> We heard evidence that our concerns were borne out by the behaviour of some engagers since implementation.<sup>43</sup> Martin McTague of the FSB said that blanket determinations reflected a “risk averse attitude on the part of many engagers, and “Where they see even the remotest risk of falling foul of an HMRC inquiry, they are choosing to take the ... line of [least] resistance”.<sup>44</sup>
25. Research conducted by IPSE showed “shifts in how clients are now determining status” with 21 per cent of freelancers reporting that their client had simply determined all engagements as inside IR35 – a blanket assessment. A further 11 per cent of freelancers reported that their client had insisted that they move onto a payroll without assessing the IR35 status of the engagement – a blanket ban.<sup>45</sup>

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<sup>38</sup> [Q 44](#) (Pete Downing)

<sup>39</sup> [Q 8](#) (Martin McTague)

<sup>40</sup> Written evidence from FCSA ([OPR0033](#))

<sup>41</sup> [Q 43](#) (Financial Secretary to the Treasury)

<sup>42</sup> Economic Affairs Committee, [Off-payroll working: treating people fairly](#) (1st Report, Session 2019-20, HL Paper 50), paras 99 and 100

<sup>43</sup> [Q 6](#) (Andrew Chamberlain)

<sup>44</sup> [Q 6](#) (Martin McTague)

<sup>45</sup> Written evidence from IPSE ([OPR0024](#))

26. You told us that it is quite legitimate for companies to decide not to use contractors working through personal service companies if they do not wish to do so.<sup>46</sup> **It is regrettable nevertheless if such decisions are driven by tax, rather than commercial, considerations.**
27. The issue of blanket determinations is different because, in failing to assess each appointment separately, engagers are not complying with the off-payroll working rules. HMRC told us that it is adopting a light-touch approach to compliance initially. Carol Bristow said: “Our plan is to try to encourage employers to self-correct. We are not going to charge penalties when we see an error. We are trying to get them into good habits and to have good systems and processes in order to make correct determinations.”<sup>47</sup>
28. **While a light-touch approach is admirable where engagers are making honest mistakes, we suggest tougher compliance action is needed where engagers are effectively evading their obligations under the rules to make individual determinations.**
29. Evidence submitted to the Sub-Committee revealed concern about the impact of such decisions on the supply chain. IPSE quoted the example of one freelancer who said, “Blanket panicked decisions by large organisations, not based on facts or working practices, have decimated the market for genuine contractors delivering outcome-based flexible skills and services.”<sup>48</sup> In respect of blanket bans, Phil Pluck of the FCSA said that they are “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.”<sup>49</sup>
30. The Sub-Committee also heard concerns about status determination appeal arrangements. Research from IPSE showed that over three quarters of those who disagreed with their status determination challenged the outcome. Of those who did so, 79 per cent reported no change as a result of the challenge but 18 per cent reported that their status determination was successfully changed.<sup>50</sup> In our 2020 report we noted that the proposals for an engager-led appeals process risked being stacked against contractors.<sup>51</sup> We were told that, as a result of the reforms, some contractors are experiencing a “take it or leave it” attitude from some engagers.<sup>52</sup> **HMRC compliance activity needs to focus on the handling of appeals by engagers to ensure satisfactory processes are put in place for the proper consideration of appeals.**
31. If contractors feel that a status determination is unfair, and cannot get the engager to change it, their only recourse is to try to correct matters through their income tax self-assessment at the end of the year.<sup>53</sup> Witnesses raised concerns about the risk to employers of putting individuals on their payroll if that treatment was subsequently challenged by either by the individual or by HMRC. Alice Jeffries of the CBI, explained that there were “risks and costs on both sides” if the engager made the wrong determination either way:

*“If the employer decides that an individual falls within payroll, they will then be responsible for paying the 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*

<sup>46</sup> [Q 40](#) (Financial Secretary to the Treasury)

<sup>47</sup> [Q 40](#) (Carol Bristow)

<sup>48</sup> Written evidence from IPSE ([OPR0024](#))

<sup>49</sup> [Q 6](#) (Phil Pluck)

<sup>50</sup> Written evidence from IPSE ([OPR0024](#))

<sup>51</sup> Economic Affairs Committee, [Off-payroll working: treating people fairly](#) (1st Report, Session 2019-20, HL Paper 50), para 92

<sup>52</sup> Written evidence from ContractorCalculator ([OPR0014](#))

<sup>53</sup> [Q 41](#) (Pete Downing)

*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.*"<sup>54</sup>

32. We put this issue to HMRC which provided a detailed response setting out the approach it will adopt to unravelling the results of incorrect determinations. The Sub-Committee is grateful to HMRC for clarifying the position.<sup>55</sup>

**33. The Sub-Committee shares the concerns raised by witnesses about blanket assessment and the engager-led appeal mechanism. HMRC needs to take steps to address these problems through its compliance activity.**

### **Impact**

#### *Impact on the Labour Market*

34. As we stated in our 2020 report, there appears to be a lack of reliable data about the number of personal service companies (PSCs) in the UK.<sup>56</sup> HMRC has estimated that overall there are 240,000 PSCs in the UK, of which 180,000 personal service companies would be directly affected by the off-payroll working changes and that up to 60,000 private sector businesses would have to apply the new rules as engagers.<sup>57</sup> Andrew Chamberlain of IPSE said that HMRC's estimate of the number of PSCs likely to be affected was "a bit on the small side" but acknowledged the difficulties in getting accurate information about PSC numbers.<sup>58</sup>

35. Our witnesses told us, however, that the number of freelancers using PSCs had reduced since the introduction of the off-payroll working reforms. Research commissioned by IPSE indicated that, since the implementation of the reforms, "more than one in three freelancers (35 per cent) report that they have left self-employment — closing their companies for retirement, moving into permanent roles, begun contracting abroad or are simply not working."<sup>59</sup> IPSE noted that this number could include some who were "genuinely in business on their own account" who had been "swept up" within the reforms.<sup>60</sup>

36. Similarly, Phil Pluck of the FCSA told us that their own surveys of contractors suggested that up to 30 per cent of contractors were going to leave contracting.<sup>61</sup> He said there had been a "loss of some extremely high skills".<sup>62</sup>

37. From an engager perspective, Alice Jeffries of the CBI said that "The departure of contractors from the labour market, whether through retiring or moving to other locations, had been a big issue", and that the general consensus among CBI members who were engagers was that the reforms have had a negative impact on their access to the labour market.<sup>63</sup>

38. We were told that some sectors were being affected more than others. The Association of Professional Staffing Companies (Global) Ltd (APSC) told us: "In the highly skilled STEM markets such as IT, life science [and] engineering ... business has long benefitted from

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<sup>54</sup> [Q 23](#) (Alice Jeffries)

<sup>55</sup> Letter from HMRC, 14 January 2022, *Further information on the reform of the off-payroll working rules*: <https://committees.parliament.uk/publications/8634/documents/87519/default/>

<sup>56</sup> Economic Affairs Committee, *Off-payroll working: treating people fairly* (1st Report, Session 2019-20, HL Paper 50), para 21

<sup>57</sup> Written Evidence from HMRC ([OPR0036](#)); Information on how these figures were calculated is contained in supplementary written evidence from HMRC ([OPR0039](#))

<sup>58</sup> [Q 2](#) (Andrew Chamberlain)

<sup>59</sup> [Q 11](#) (Andrew Chamberlain); Written evidence from IPSE ([OPR0024](#))

<sup>60</sup> [Q 5](#) (Andrew Chamberlain)

<sup>61</sup> [Q 4](#) (Phil Pluck)

<sup>62</sup> [Q 3](#) (Phil Pluck)

<sup>63</sup> [Q 28](#) (Alice Jeffries)

accessing highly skilled technical expertise on an ‘as needed’ basis delivered by independent contractors”, a route which had been “seriously hindered” by the reforms.<sup>64</sup>

39. Our witnesses acknowledged that other factors have had an impact on the contractor market, particularly in the case of European contractors who had based themselves in the UK.<sup>65</sup> Alice Jeffries of the CBI said that some sectors, that had already seen pressures from the effects of EU withdrawal and the Covid-19 pandemic, were seeing these exacerbated by the April 2021 changes.<sup>66</sup> Andrew Chamberlain of IPSE told us that in his view the UK’s one-time reputation for being “an easy place to start up in business” had been replaced by “a sense of a huge compliance burden [and] a punitive tax regime, which makes it much less attractive overall”.<sup>67</sup>
40. In your evidence to us, you said that it would be of concern if skilled labour was leaving the UK and that this would be something that would be looked at in the research that HMRC has commissioned into the short-term effects of the April 2021 reforms.<sup>68</sup>
41. We received evidence expressing concern about the impact of the reforms on flexibility within the labour market. IPSE wrote: “This legislation has absolutely damaged UK business operating flexibility, as previously, non-essential staff requirements would have been filled by contractors that can be given reasonably short notice when adverse business conditions arise”.<sup>69</sup> Alice Jeffries of the CBI told us that short term contract work had been “significantly affected” as a result of the increased compliance burden under the reforms: “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.”<sup>70</sup>
42. For contractors assessed as within the off-payroll rules by an engager, we were told that there is likely to be a financial cost given the differential tax and NIC treatment of an employee as compared to a contractor.<sup>71</sup> We were told that a key issue here is employer NICs and how the cost of that is allocated between engager and contractor<sup>72</sup> — and that this will be added to by the health and social care levy.<sup>73</sup> Alice Jeffries of the CBI told us it sees “the more skilled end of the market being much more able to choose to put costs back on to ... the engager and to choose what they do within the market” than the those less highly-skilled are able to do.<sup>74</sup> Martin McTague of the FSB agreed: “if you have market power, essentially you put your rates up and you can encompass the new position in your inflated rates” whilst those without market power were likely to end up in an umbrella company (which we discuss below).<sup>75</sup>
43. HMRC wrote that it is too soon to evaluate the impact of the April 2021 reform in the private sector but that it intends to evaluate the long-term effects of the changes.<sup>76</sup> You told us that the independent research into the public sector reforms found that there was “no significant disruption” to the use of contingent labour by public sector bodies as a result of

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<sup>64</sup> Written evidence from APSC ([OPR0023](#))

<sup>65</sup> [Q 3](#) (Phil Pluck)

<sup>66</sup> [Q 28](#) (Alice Jeffries); The CBI said relevant sectors were IT, defence, logistics and construction

<sup>67</sup> [Q 15](#) (Andrew Chamberlain)

<sup>68</sup> [Q 46](#) (Financial Secretary to the Treasury)

<sup>69</sup> Written evidence from IPSE ([OPR0024](#))

<sup>70</sup> [Q 28](#) (Alice Jeffries)

<sup>71</sup> [Q 11](#) (Andrew Chamberlain)

<sup>72</sup> [Q 11](#) (Andrew Chamberlain)

<sup>73</sup> [Q 22](#) (Colin Ben-Nathan); [Q 13](#) (Andrew Chamberlain, Phil Pluck)

<sup>74</sup> [Q 24](#) (Alice Jeffries)

<sup>75</sup> [Q 11](#) (Martin McTague)

<sup>76</sup> Written evidence from HMRC ([OPR0039](#))

the changes but acknowledged the need to look at the extent to which the reforms changed people's behaviour and what that meant for the labour market.<sup>77</sup>

44. As discussed above, HMRC has commissioned research into the short-term effects of the reforms. You told us that this would be focused on engagers and would look at the impacts on contractor working, and that could include looking at the impact on contractor rates.<sup>78</sup>
45. **The Sub-Committee is very concerned about the impact that these changes are having on the labour market. We are not convinced that the Government is confronting the challenges that both businesses and workers face because of the new rules. The research to show the real impact of these rules should therefore be conducted expeditiously.**
46. **As we recommended in our 2020 report, research into the impact of the measures must take into account the wider impact of the changes on the UK's labour market and the broader economy. The Sub-Committee believes that the scope of this research should be more comprehensive and in particular should invite input from affected contractors as well as engagers and intermediaries.**

*Impact on businesses and workers*

47. HMRC originally estimated the one-off administrative cost incurred by business in preparing to operate the off-payroll rules would be £14.4 million, with an ongoing negligible net impact. The Sub-Committee challenged this estimate as witnesses to our earlier inquiry considered it to be too low. HMRC revisited their estimates, resulting in an increase in the one-off cost estimate to £19.7 million, with an ongoing net saving of £0.3 million.<sup>79</sup>
48. The CBI wrote that the original figure of £14.4 million was a "gross underestimate" given that HMRC required engagers to consider the status of each appointment individually and to make a determination on a just and reasonable basis.<sup>80</sup> Alice Jeffries of the CBI said that, in the CBI's view, the revised estimate of £19 million was still an underestimate, and that the ongoing compliance cost to businesses of the reforms "is probably larger than the one-off cost that HMRC originally envisioned".<sup>81</sup> The ongoing cost would include training hiring managers on an ongoing basis and dealing with disputes that might arise over several years. HMRC told us that it would be revisiting its assessment of costs to businesses in the research to be carried out.<sup>82</sup>
49. **We believe that HMRC has failed to appreciate the burden of costs that the new rules are imposing on compliant companies. It is right that this issue is revisited by HMRC in the research into implementation of the rules.**
50. In principle engagers should also be incurring the cost of employers' NICs (and health and social care levy) for those contractors they determine to be operating with the off-payroll rules. However as mentioned above we heard evidence that the cost of employers' NICs was effectively being passed on to contractors through lower rates of pay. Andrew Chamberlain said:

"Let us say you were on £400 a day and 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

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<sup>77</sup> [Q 38](#) (Financial Secretary to the Treasury)

<sup>78</sup> [Q 47](#) (Financial Secretary to the Treasury)

<sup>79</sup> Written evidence from HMRC ([OPR0036](#))

<sup>80</sup> Written evidence from CBI ([OPR0038](#))

<sup>81</sup> [Q 17](#) (Alice Jeffries)

<sup>82</sup> [Q 42](#) (Carol Bristow)

they do not want to pay that ... So you get a new day rate. Your new day rate, or your assignment rate ... will probably be 20% less than it was before.”<sup>83</sup>

51. He said that the same thing was happening with the 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.”<sup>84</sup>
52. Similarly, the FCSA noted that the cost of managed service companies will often have to be absorbed by the contractor. Phil Pluck said “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 someone has to absorb that cost and in our observation that is often the contractor.”<sup>85</sup>
53. **One of the drivers behind the tax avoidance, which IR35 and the off-payroll rules were designed to address, was engagers’ desire to avoid paying employers’ NICs. Yet in practice it seems many engagers are still not accepting this responsibility, but passing it on to contractors via reduced rates of pay. It is lower paid contractors with the least bargaining power who are most disadvantaged.**

### **Umbrella Companies**

54. In the 2020 report the Sub-Committee warned of the risks presented by umbrella companies and the likelihood that the use of umbrella companies would increase with the extension of the off-payroll rules to the private sector.<sup>86</sup>
55. There has been at least a fivefold increase in the number of individuals working through umbrella companies in the last fifteen years. HMRC told us it estimated 100,000 individuals were working through umbrella companies in 2007–08 but by 2020–21 this had increased to at least 500,000, while external commentators’ estimate was 600,000.<sup>87</sup>
56. Witnesses told us that this trend is continuing since the implementation of the new rules. IPSE told us that its research found that “the increase in ‘inside IR35’ roles has also resulted in 34 per cent of freelancers now operating via an umbrella company — considerably higher than anticipated prior to the reforms (19 per cent expected to be operating through umbrella companies)”.<sup>88</sup> The FCSA reported that its most recent research in October 2021 showed an increase by 39 per cent in the number of contractors working through umbrella companies since March 2021.<sup>89</sup> The LITRG noted that under the new rules many contractors have stopped working through their own companies, as the cost savings of doing so have disappeared but the complexity and additional administration remains. Although some may have been taken on by engagers as employees, LITRG told us that for others: “either by choice or at the request of engagers they are now working through umbrella companies.”<sup>90</sup>
57. Many umbrella companies are fulfilling a useful function. Meredith McCammond of the LITRG spoke of some providing a “safe harbour” for contractors affected by the new rules

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<sup>83</sup> [Q 11](#) (Andrew Chamberlain)

<sup>84</sup> [Q 11](#) (Andrew Chamberlain)

<sup>85</sup> [Q 6](#) (Phil Pluck)

<sup>86</sup> Economic Affairs Committee, [Off-payroll working: treating people fairly](#) (1st Report, Session 2019-20, HL Paper 50), paras 93-94

<sup>87</sup> Letter from HMRC, 14 January 2022, *Further information on the reform of the off-payroll working rules*: <https://committees.parliament.uk/publications/8634/documents/87519/default/>

<sup>88</sup> Written evidence from IPSE ([OPR0024](#))

<sup>89</sup> Written evidence from FCSA ([OPR0033](#))

<sup>90</sup> Written evidence from LITRG ([OPR0012](#))

and said “there are some very good umbrellas out there”.<sup>91</sup> Martin McTague of FSB said that employees of well run and authentic umbrella companies “effectively have employee rights” and were “on the same footing as everybody else who is employed”.<sup>92</sup>

58. There was, however, concern about the activities of rogue umbrella companies associated with tax avoidance. Phil Pluck of the FCSA said there was a “worrying trend” whereby umbrella companies sought to lure contractors with unrealistic offers. As he explained:
- “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.”<sup>93</sup>
59. The FCSA noted that lower paid workers were more likely to be persuaded to be lured into unlawful schemes, because they are offered highly plausible solutions which show how they might increase their income at a time when their finances are under pressure.<sup>94</sup> Phil Pluck of the FCSA said: “We also have to accept that IR35 has forced lots of people into umbrella employment, and they are therefore not necessarily as educated as they could or should be when they choose an umbrella organisation.”<sup>95</sup>
60. **The Sub-Committee is very concerned that to note that the extension of the off-payroll rules to the private sector is resulting in greater numbers of people using umbrella companies; and increasing the risk that some individuals, particularly those on low incomes, will become involved with rogue umbrella companies associated with tax avoidance. Paradoxically, this appears to substitute one form of tax avoidance for another.**
61. In terms of addressing the problem of non-compliant umbrellas, Colin Ben-Nathan of CIOT said that publicity was essential “so that workers are aware of where their pay may not be being calculated correctly”.<sup>96</sup> There was a need for more work on the wider message as well as targeted messages on payslips for employees in umbrella companies “to join the dots” for individuals.<sup>97</sup>
62. Witnesses also raised concern about the impact of the activities of non-compliant umbrella companies on those that are compliant. We were told that pressure from non-compliant umbrella companies (effectively undercutting the compliant) “will make it very difficult for compliant umbrellas to carry on. It will erode their ability to trade.”<sup>98</sup>
63. HMRC told us of some of the work it has been doing to tackle rogue umbrella companies using their powers under Disclosure of Tax Avoidance Schemes (DOTAS) and Promoters of Tax Avoidance Schemes (POTAS) and the enablers penalty legislation. We note that HMRC’s powers were strengthened in the Finance Act 2021 and further legislation is included in the Finance Bill 2021-22. HMRC has also taken steps to warn potential users

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<sup>91</sup> [Q 29](#) (Meredith McCammond)

<sup>92</sup> [Q 11](#) (Martin McTague)

<sup>93</sup> [Q 11](#) (Phil Pluck)

<sup>94</sup> Written evidence from FCSA ([OPR0033](#))

<sup>95</sup> [Q 12](#) (Phil Pluck)

<sup>96</sup> [Q 30](#) (Colin Ben-Nathan)

<sup>97</sup> [Q 30](#) (Colin Ben-Nathan)

<sup>98</sup> [Q 12](#) (Martin McTague)

through its “Tax Avoidance – Don’t get caught” campaign; and, since April 2020, have written to warn 33,000 individuals likely to be involved in schemes.<sup>99</sup>

64. In November 2021 the Government launched a call for evidence inviting views from stakeholders about the role that umbrella companies play in the labour market.<sup>100</sup> The consultation period on the call for evidence expires at the end of February.
65. **The Sub-Committee welcomes the call for evidence but we would have liked to see a greater focus on the protection of workers using the services of umbrella companies and a clearer indication of the Government’s intentions. The Sub-Committee feels that the Government has been slow to act against the harm caused by the activity of non-compliant umbrella companies.**
66. **We recommend an early indication of what use the Government intends to make of the information it collects, what action is proposed and to what timescale.**
67. Similarly, the Government has already recognised that umbrella companies need to be properly regulated and has announced proposals for a single enforcement body to do this. However, there is still no sign of legislation being introduced to create such a body. You said that there would be legislation ‘as soon as parliamentary time allows for an employment bill’.<sup>101</sup>
68. Phil Pluck of FCSA told us: “We have seen very clear evidence that it [IR35] 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 these 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.”<sup>102</sup>
69. **The Sub-Committee is very concerned that the off-payroll rules are encouraging the insertion of unnecessary intermediaries into the supply chain, adding to costs and opportunities for “rogue” operators. We believe that effective action requires a stronger focus on worker protection.**
70. **In the absence of effective statutory action, umbrella companies are proliferating. More and more individuals are at risk of getting caught up in tax avoidance schemes. The Government needs to commit to a date for bringing forward legislation to create the proposed single enforcement body to regulate umbrella companies.**

### **Employment Status**

71. You told us that the objective of the off-payroll rules is to achieve fairness between people who are essentially doing the same job: “everyone doing the same job should be paying the same tax”.<sup>103</sup> **We agree with this in principle, but we are concerned that if the objective is to ensure fairness between individuals, the assessment of what is “fair” cannot be restricted to tax in isolation: it must also apply to employment rights.** In the 2020 report, the Sub-Committee pointed out the unfairness of taxing

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<sup>99</sup> Written evidence from HMRC ([OPR0036](#))

<sup>100</sup> HMRC, *call for evidence: umbrella company market* <https://www.gov.uk/government/consultations/call-for-evidence-umbrella-company-market> [accessed 26 January 2022]

<sup>101</sup> [Q 46](#) (Financial Secretary to the Treasury)

<sup>102</sup> [Q 12](#) (Phil Pluck)

<sup>103</sup> [Q 33](#) (Financial Secretary to the Treasury)

individuals as employees for tax purposes while denying them employment rights.<sup>104</sup> We recommended that the Government take forward the proposals set out in *Good Work: the Taylor Review of modern working practices* on employment status.<sup>105</sup> The Taylor Review proposals took a more rounded and holistic view and we concluded offers ‘the best long-term solution, and provides the opportunity to consider tax, rights and risk together’.<sup>106</sup>

72. A number of our witnesses told us that many of the problems relating to status determination and the role of CEST came back to the fundamental, and, as the LITRG described it, “notoriously difficult”, issue of employment status.<sup>107</sup> Andrew Chamberlain (IPSE) said: “If we could get clearer rules on employment status, that would be the key to sorting this out. The rules we have right now are not clear.”<sup>108</sup> Martin McTague of FSB agreed that the issues around employment status were “the root cause of the problem ... 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 [additional] issues.”<sup>109</sup>
- 73. It is disappointing that nearly two years on from our earlier report, no significant progress appears to have been made in addressing the wider issues around employment status or implementing the Taylor Review’s proposals.**
- 74. The mismatch between tax law and employment has resulted in a situation where individuals are treated as employees for tax purposes but without the rights which are normally associated with employment. In taking forward the off-payroll working reforms, the Government has focussed too narrowly on tax issues and not enough on wider issues of fairness.**
- 75. The Sub-Committee reaffirms its earlier recommendation that the Government should implement the Taylor Review proposals. There is now even greater urgency in defining employment status for both tax and employment rights purposes.**

#### Key conclusions

- 76. We welcome HMRC’s decision to commission external research into the implementation and short-term effects of the extension of the off-payroll rules in the private sector. In light of our concerns about the impact that the new rules appear to have had on the labour market, we believe that this research into their impact needs to be made comprehensive and accelerated. Once completed, it should be published in full.**
- 77. The off-payroll working rules appear to have resulted in an increased use of umbrella companies, some of which are associated with tax avoidance. This is highly regrettable, given that the purpose of the off-payroll rules is to curb tax avoidance. While we welcome the call for evidence on umbrella companies, and the work HMRC has done to counter rogue umbrella companies, we believe that this work needs greater urgency.**

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<sup>104</sup> Economic Affairs Committee, *Off-payroll working: treating people fairly* (1st Report, Session 2019-20, HL Paper 50), para 172

<sup>105</sup> Department for Business, Energy and Industrial Strategy, *Good work: the Taylor review of modern working practices* (11 July 2017) <https://www.gov.uk/government/publications/good-work-the-taylor-review-of-modern-working-practices> [Accessed 28 January 2022]

<sup>106</sup> Economic Affairs Committee, *Off-payroll working: treating people fairly* (1st Report, Session 2019-20, HL Paper 50), para 172

<sup>107</sup> [Q 22](#) (Meredith McCammond)

<sup>108</sup> [Q 8](#) (Andrew Chamberlain)

<sup>109</sup> [Q 14](#) (Martin McTague)

**78. Above all, if the Government is truly committed to fairness in the workplace, it must take a coherent approach to the issue of employment status, which considers both tax and employment rights. It is unfair that individuals are treated as employees for tax purposes but without the rights which are normally associated with employment. To address this, the Government should press ahead with implementing the proposals set out in the Taylor Review as the Sub-Committee recommended in our 2020 report.**

Thank you again for appearing before the Sub-Committee. I look forward to receiving your response.

Yours sincerely,

A handwritten signature in black ink, reading "George Bridger". The signature is written in a cursive, flowing style.

The Lord Bridges of Headley.  
Chair, Economic Affairs Finance Bill Sub-Committee.