

HMRC and HMT supplementary written evidence

Lords Economic Affairs Finance Bill Sub-Committee – further information

A: Estimate of non-compliance

The Committee asked for further information on how HMRC had estimated the level of noncompliance with the existing off-payroll working rules. As the committee is aware, the offpayroll working rules apply to Personal Service Companies.

Firstly, it is worth noting that there is no legal definition of a Personal Service Company (PSC) that would enable HMRC to identify it from its CTSA systems. HMRC uses proxy indicators including the number of employees, level of turnover, profit ratio and balance sheet tests in order to estimate the PSC population. This proxy definition was agreed with the Office for Budget Responsibility (OBR). This population represents individuals that are working through their own personal service company and does not include unincorporated individuals providing a personal service who are self-employed.

HMRC estimates that only 10% of PSCs that should apply the off-payroll working rules actually do so. This estimate is based on previous self-assessment tax return data which asked individuals operating through service companies 'Have you operated the Intermediaries legislation (sometimes known as IR35) or the Managed Service Companies legislation?'. This question should be ticked if you have applied the legislation and have determined your employment status to be either inside or outside of the rules. Respondents who ticked yes were classed as compliant, meaning that they were determining their employment status. The compliant number as a proportion of the PSC population that HMRC believes should be applying the rules was around 10%. This analysis and assumption formed part of the estimate of the exchequer impact from these reforms that was verified by the OBR at Budget 2018. .

HMRC has also received anecdotal evidence from stakeholders which supports HMRC's view that non-compliance with the off-payroll working rules is widespread within the industry.

B: Administrative burden of the reform

The Committee also asked for further detail on the methodology that HMRC used in estimating the administrative burden to businesses of implementing this reform.

The estimated administrative burden of the reform was published in a Tax Information and Impact Note on 11 July 2019. HMRC estimated that the one-off cost to businesses of implementing the reform was £14.4 million. This figure is broken down in Table 1.

| Table 1: One-off administrative burden (£m) | |
|---|-------------|
| Change in burden to PSCs: | 3.2 |
| Familiarisation with new rules by PSCs | 3.2 |
| Change in burden for end clients: | 11.2 |
| Familiarisation with new rules by engager/fee-payers | 5.9 |
| Investment by engagers/fee-payers in additional IT systems to process IR35 claims | 2.3 |
| Training of Engagers and fee payer staff | 1.9 |
| Set-up of dispute resolution process by engagers | 0.1 |
| Admin burden from adding an additional employee in Real Time Information (RTI): | 0.9 |
| Overall administrative burden impact | 14.4 |

In addition, HMRC also estimated the ongoing administrative burden for end clients to be £5.3 million per year, with PSCs achieving a saving of £5.3 million. This estimate is set out in Table 2.

| Table 2: Ongoing administrative burden (£m) | |
|--|-------------|
| Change in burden to PSCs: | -5.3 |
| Admin burden from checking IR35 online and whether it applies and from considering Employment Status Test: | -4.5 |
| of which from no longer having to figure out deemed payments | -0.9 |
| Change in burden for end clients: | 5.3 |
| Employment status test for each off-payroll worker | 2.2 |
| Admin burden from adding an additional employee in RTI: | 0.0 |
| Admin burden from placing invoices onto payroll: | 1.9 |
| Communication to off-payroll worker & fee-payer of status determination and reasons | 0.4 |
| Ongoing maintenance of status disagreement process | 0.9 |
| Net admin burden impact | NIL |

HMRC's estimates of the population impacted by the off-payroll working reform uses methodology and assumptions agreed by the OBR. The administrative burden calculation uses average hourly cost from the

Standard Cost Model (SCM). The hourly wage rates for a particular grade are obtained from the Office for National Statistics Annual Survey of Hours and Earnings with added 30% uplift for overhead costs. Assumptions on the average time taken for each change in burden, the proportion of engagers and end clients using an agent, and the proportion of companies building new IT systems were agreed internally based on consultation.

When calculating the administrative burden of the reform, HMRC considers the average costs of becoming familiar with and administering the new rules by estimating the amount of time taken by an organisation and the average hourly cost, factoring in the additional costs to those engaging a tax accountant. This is then applied to the estimated population. The methodology also takes into account the differing costs depending on the size of the engager or deemed employer, with larger engagers likely to incur greater costs. However, the methodology also recognises that organisations will have different hiring practices, taking on different levels of contingent labour, irrespective of their size.

As stated to the Committee during the evidence session, HMRC has committed to revisiting the methodology used to estimate the administrative burden on businesses in implementing this reform.

C: HMRC implementation costs

The Committee has asked for further details of the estimated costs to HMRC of implementing the off-payroll working reform. As set out in the Tax Information and Impact Note on 11 July 2019, the operational impacts on HMRC of implementing this measure are in the region of £21 million over a six-year period from 2018/2019 to 2023/2024.

This estimate covers the costs of setting up a new team to provide education and support to businesses and individuals, the costs of HMRC's compliance resource, operating our dedicated helpline and the costs of the IT changes that HMRC are making. This includes the enhancements to CEST, changes to the RTI system and the publication of new guidance.

The estimated cost can be broken down into the following areas:

| Category | Cost (£m) |
|--|------------------|
| Staff costs for the delivery and operation of the reform | 19.01 |
| IT costs – such as changes to the RTI and Self-Assessment systems, as well as ongoing IT maintenance | 2.13 |
| Enhancements to CEST | 0.75 |

D: Additional questions asked by the committee

a) HMRC told us that, by 2023-24, the reforms will bring in additional revenues of £3 billion – but that the loss that they are intended to protect against is £1.3 billion. Can you explain the difference in these amounts?

The figures quoted are in respect of different time periods. The cost of non-compliance is estimated to reach £1.3 billion per year by 2023/24 without the reform to the off-payroll working rules. The £3 billion in additional revenues stated at Budget 2018 is the cumulative net revenue across the period 2019/20 to 2023/24.

You will note that the estimated additional revenue for 2023/24 is stated as £725 million in the original Budget 2018 costing, which is less than the £1.3 billion estimated total non-compliance for that year. The reason for this is because HMRC does not expect to be able to recover all of the potential lost revenue, as the methodology assumes a relatively high degree of attrition in the yield as taxpayers seek to mitigate the impact of the changes. This is standard in most costings. Furthermore, the £1.3 billion estimate is for the whole of the private sector, whereas the reform does not apply to small business engagers. By introducing the reform, HMRC expects to see a behavioural change which will reduce the level of non-compliance that would otherwise have continued, thereby reducing the estimated lost revenue of £1.3 billion.

Autumn Budget 2018 - costing¹

| £m | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 | 2023-24 |
|--------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Budget 2018 | -5 | -150 | +1,165 | +595 | +635 | +725 |

For Budget 2020, the measure was re-costed, as is normal for a fiscal event. As a result, the reform to the off-payroll working rules is now forecast to be approximately 10% higher over the same period, now estimated to raise £3.3 billion in additional revenue.

Spring Budget 2020 – re-costing²

| £m | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 | 2023-24 | 2024-25 |
|-------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Spring Budget 2020 recosting | | -150 | +1,190 | +705 | +710 | +800 | +870 |

¹ Published in Table 2.1 of Budget 2018 on 29 October 2018:

<https://www.gov.uk/government/publications/budget-2018-documents/budget-2018> ² Published in Table 2.2 of Budget 2020 on 11 March 2020:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/871657/Table_2.2_final.xlsx

The yield is higher than previously estimated due to a number of factors, the main ones being:

- The number of personal service companies has grown faster than originally forecast;
- Increased PAYE yield from the off-payroll reforms is offset by a reduction in dividend tax receipts and corporation tax receipts. We have observed higher profit retention and hence lower dividends in the latest outturn data for PSCs coinciding with the introduction of the Dividend Allowance and the public sector reform. Given that higher profit retention leads to lower dividends, this results in less offsetting cost. Our latest estimates factor in the new retained profit assumptions, hence the higher yield.

b) Witnesses reported concerns that the off-payroll working rules are likely to distort business decisions about resourcing, and therefore risk damaging the economy. What is your response to this claim?

The way that people work is changing. Allowing individuals and businesses to agree working arrangements to suit their needs is an important pillar of the labour market's success. The Government values the contribution of all flexible workers to the UK economy. These changes will ensure that tax that was always due is paid.

Under the existing rules, around 90% of the PSCs that should have been applying the rules were not doing so correctly, meaning the tax due was not paid. Shifting the responsibility for applying the rules will address this non-compliance, so it is natural that businesses will reconsider whether PSCs are still the best way to engage contractors who are working like employees. This is a business decision for organisations to make and following the introduction of the reforms we expect to see more contractors being paid via PAYE, as this more accurately reflects the way these individuals actually work.

This does not indicate any change in demand for the services and skills that contractors offer, and we do not expect any significant macroeconomic impacts. Many organisations will still choose to engage contractors through a PSC, where this suits the organisation's business model.

HMRC commissioned IFF Research and Frontier Economics to conduct independent research on the impacts of the reform in the public sector. The research consisted of a quantitative survey of public bodies and sites who had recently engaged with off-payroll contractors and follow up interviews with respondents who indicated they had been affected by the

reforms. This research found no significant change to the use of contractors, no significant impact on recruitment or the ability to hire flexible labour, as well as no evidence of widespread blanket assessments.

c) Witnesses told us that alternative ideas were put forward as part of HMRC's consultation, but then ruled out. The consultation effectively focussed on changes to IR35 rather than considering from first principles whether it was the right approach. Is this the best way to tackle issues raised by a changing labour market?

The principle of the IR35 rules is that people who are working like employees, but through their own company, should be taxed in the same way as direct employees. The Government's objective is to significantly improve the compliance with these rules to reduce the significant loss to the exchequer from the status quo.

Alternative ideas on how contractors could be taxed in a different way were put forward during the consultation process. However, any alternative ideas that created a new tax regime or different treatment for contractors which still allowed them to work like employees but be taxed in a different or advantageous way to employees was ruled out on the basis that it still resulted in an unfairness in the tax system.

It would not be fair for individuals with the same underlying legal employment status to be taxed in different ways. Employment status law applies to all other individuals regardless of their employment structure, including employees, the self-employed and sole traders. It would not be fair for contractors to have a different regime in virtue of their incorporated status.