

# **Recruitment and Employment Confederation – Written evidence (OPR0018)**

## **Introduction**

The REC welcomes the opportunity to provide evidence to the House of Lords Finance Bill Sub-Committee call for evidence.

Firms in the recruitment industry place nearly 1 million people into temporary and contract work every day, and 1 million more into permanent placements every year. That makes recruiters experts when it comes to the world of work. On 6 April, the off-payroll rules for the private sector changed to mirror the rules that have applied in the public sector since April 2017. So, clients who are not exempt from the off-payroll rules - that is medium and large organisations in the private sector - are now legally required under the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) to assess the IR35 status of each engagement for contractors who have a material interest or non-material interest in an intermediary – typically a personal services company (PSC). Clients are then required to communicate their IR35 status decision in the form of a Status Determination Statement (SDS) and then give it to the contractor and any employment businesses in the supply chain.

We agree that it is vital that people pay the right amount of tax. But as we have stated previously, to ensure the system works, the government must get the legislation right. Our primary concern is that the effective regulation of umbrella companies is still not in place following the absence of an Employment Bill. Although we're pleased that the Department for Business, Energy, and Industrial Strategy (BEIS) is in the process of drafting the definition for umbrella companies, the absence of regulation today is creating opportunities for avoidance. This is particularly frustrating for compliant companies, who do not feel we have a level playing field at present.

## **Has the recent extension of the off-payroll working rules to the private sector made it more difficult for engagers to hire people with the right skills and expertise? To what extent has its introduction contributed to job vacancies?**

1. Feedback from recruiters shows that changes in off-payroll working are still affecting both placements and the availability of flexible workers. According to the REC's latest Report on Jobs data (*Figure 1*), the number of people available for new roles has continued to decline month on month since May.

## Permanent / Temporary

sa, >50 = improvement since previous month



## Temporary Staff Availability Index

sa, >50 = improvement since previous month

	UK	London	South	Midlands	North
May '21	35.3	47.8	29.8	40.2	27.8
Jun '21	27.0	41.4	25.6	27.3	21.6
Jul '21	27.6	34.3	26.6	26.2	27.1
Aug '21	25.4	28.0	23.7	25.9	27.5
Sep '21	28.4	25.8	28.8	27.8	28.6
Oct '21	28.9	28.8	27.7	29.8	30.7

Figure 1: Staff availability (Report on Jobs, November 2021)

2. Our October data showed that labour shortages and efforts to secure staff were widely linked to the latest increase in wages, while IR35 legislation was also cited as having pushed up pay – particularly reflected in the temporary market.
3. In September, the REC surveyed its members to better understand the causes of the labour and skills shortages. Our data showed that just under 30% of respondents found new off-payroll working regulations were factors affecting their ability to source suitable candidates. When we look at the sector specific breakdown, almost 40% of respondents in construction, logistics and driving cite IR35 regulations as a factor affecting their ability to find candidates.
4. The administrative burden, mainly for the hirer to comply with new rules, makes it significantly more difficult and time-consuming to commence an engagement, leading to commercial inefficiencies; there is a material cost in terms of hours spent negotiating contracts and explaining the position to contractors, in addition to internal training, external technical advice, and meeting procedural requirements.
5. Any engagement potentially within scope also requires an in-depth consideration of the myriad case law concerning employment status for tax purposes, which in most commercial scenarios is difficult to apply and a definitive conclusion is difficult to reach. The CEST tool and associated

guidance provide limited assistance in most real world scenarios, and the subjective nature of the questions in most contexts often leads to disagreement between contractors (who seek to rely on potentially inaccurate CEST results) and hirers who cannot in good conscience rely on the outcome of the CEST tool because, even when completed in accordance with HMRC guidance, the results often do not accurately reflect the case law or allow all relevant factors to be weighed up in the context of the factual scenario (as is required to properly consider the position from a technical perspective). This adds to the inefficiencies.

**For those engagers (and their advisers) who use the CEST (Check Employment for Tax Status) tool to assess employment status, how effective do you consider it to be? Do you have confidence in its results? If not, what further improvements need to be made to it?**

6. Although some minor improvements have been made to HMRC's CEST tool, there is broad consensus that it is not fit for purpose. HMRC's view that mutuality of obligation should not form part of the questions in the CEST tool on the basis that the parties in all assignments have agreed to the contract, does not reflect the reality of the contracting environment. This has been reflected in the recent Professional Game Match Officials Ltd (PGMOL) case, with both the First-tier Tribunal (FTT) and Upper Tribunal (UTT) finding that the referees were not employees of PGMOL. HMRC's position was that the question of mutuality of obligation only goes to whether a contract exists at all – an assumption which has been built into the CEST tool.
7. In addition, the questions are too imprecise to be useful in most commercial scenarios, and the examples in the CEST guidance (e.g., painting and decorating or market research) are generally irrelevant in sectors where consultancy arrangements are most common for most businesses, for example, where contractors are required to deliver professional services, IT solutions or media advice.
8. The CEST tool also appears inaccurate. Oftentimes changing the response to a single question can change a determination from "inside IR35" to "outside IR35". The case law on employment status for tax purposes is clear that one factor is unlikely to be determinative and that all relevant factors should be considered, and the weight/relevance of each factor considered in the round and in the context of the contract/engagement concerned. As a consequence, the CEST tool is not sophisticated enough for hirers to be able to rely on it in many cases to meet their obligation under the rules (at section 61NA (2)) to use reasonable care when reaching a conclusion. The sheer number of "undetermined" outcomes also undermine the usefulness of the tool.
9. The potential inaccuracy of CEST, combined with the subjective nature of the questions in most contexts, results in disagreements between hirers and contractors who must then resort to debating the nuances of the case law tests. The Department for Work and Pensions owing HM Revenue & Customs nearly £87m for "historic errors" in assessing tax liability for DWP off-payroll workers over the period 2017-21 is a clear example of the flaws with the CEST tool which should be reviewed. This outcome further reinforces the difficulties that both public and private sector organisations

have had with meeting their obligations. Furthermore, agencies who are fee payers are in an unfair predicament of being liable for a status determination that they did not make and where there is an incorrect determination of an IR35 status, that would also mean that additional costs have been wrongly applied to their charge rate - employer's NICs at 13.8%, VAT which may or may not be recoverable, or the agency may find that its payroll wrongly reaches the £3 million threshold at which the apprenticeship levy applies. Recovering overpayments from HMRC remains challenging because the legislation does not allow for an offset of tax where there has been an overpayment. Agencies have little or no influence on the tax status decision or employment status of the off-payroll worker but carry a disproportionate compliance burden and liability.

**What changes have engagers had to make to apply the off-payroll rules to contractors, in terms of systems, personnel and training? By reference to your own experience, to what extent (if any) do you consider that compliance costs have increased because of the changes?**

10. Off-payroll working legislation is extremely complex. Many businesses, including our members and their clients find off-payroll working legislation the most difficult tax legislation to understand.

11. Costs have increased in a range of ways, including:

- Training.
- Production of precedent documents for due diligence of contractors and status determinations.
- Upgrading payroll software to allow for payments under the off-payroll rules.
- Amending invoice payment protocols to distinguish between "inside" and "outside" IR35 payments.
- Amending payment protocols to ensure the VAT element of invoices (and net of payroll tax amount) are paid at the same time as amounts are accounted for through PAYE.
- Considering employment status requires expertise; tax compliance and HR resources within the firm stretched more thinly due to the technical case law nature of the tests.

**How well has HMRC supported engagers, contractors, and their advisers with the implementation of the new rules and is any further or different type of assistance needed?**

12. First and foremost, we need an adequate CEST tool in place. Secondly, HMRC must reinforce to clients their statutory obligation to provide a Status Determination Statement (SDS) and not to shift their responsibility to other parties in the supply chain.

13. We constantly get feedback from our members where clients are refusing to produce the SDS and instead simply inform the fee payer and contractor that the role is inside IR35 without explaining how they reached the decision. Client making a blanket decision that all PSC engagements are

inside IR35 is not reasonable care. Some clients continue to issue blanket decisions which raises two issues:

- This means there is a very real risk of moving from false self-employment to false employment and some of those contractors will challenge those decisions and seek tax rebates.
- It also suggests that clients either (1) do not trust the CEST tool for reasons stated above, or (2) do not have the capacity to do individual assessments on an engagement-by-engagement basis.

**To what extent has the introduction of the new rules generated disputes between engagers and contractors, concerning the status of contractors *vis à vis* the rules, and how successfully or otherwise have these been resolved?**

14. Our members and contractors have questioned the client's SDS. However, we still maintain that the legislation including a client led disagreement process will not often result in a fair outcome for the fee payer or the contractor. All parties should be able to rely on a statutory process managed by HMRC and not a client-led process – disagreements about a decision should not be managed by the client who made the decision in the first place. It is highly unlikely that a client would change its mind on a status decision that it has already made, merely because there is a disagreement (even less so if the client is satisfied that it has taken reasonable care in making its decision). There should be a requirement for the client to resolve the disagreement before the individual first provides their services (time permitting) and therefore before any payments for those services become due. This would mean that payments would be subject to the correct tax treatment from the outset.
15. As the legislation does not provide prescriptive steps on what the disagreement process should look like, and the process is weighted in favour of the client, the only solution where disputes have arisen is either to part company or to seek to negotiate commercial changes to the arrangements, to compensate contractors for the tax implications of disputed "inside IR35" determinations.

**What behavioural effects have resulted from the introduction of the new rules in the private sector in terms of the arrangements adopted in hiring contractors?**

16. As a result of the off-payroll changes in the public and private sector, there has been a proliferation of umbrella companies who interposed themselves between agencies and personal service companies, thus becoming the feepayer and increasing the length of the supply chain. It is commonly known that some umbrella companies are non-compliant and operate disguised remuneration schemes. These schemes claim to prevent certain payments made to workers from being taxable. They aim to do this by describing taxable earnings paid to a worker for doing their job as something that is non-taxable instead. We are aware that BEIS is looking at ways to define umbrella companies in legislation as part of the Good Work Plan. For many years, The REC has called on the government to properly regulate the umbrella / intermediary market. While there are

compliant umbrellas in the market, there are others which are not, and it can be difficult for agencies and workers alike to distinguish between the two.

17. There has also been an increase in the use of Statement of Work arrangements which is specifically mentioned in the legislation. However, some agencies are entering into Statement of Work arrangements, even when their business model has traditionally been to provide temporary labour, as their clients have started to require this type of contract to minimise their IR35 risk. This model requires agencies to extend their service offered to their clients and they are an outsourced contractor or consultancy, where the hirer only pays on the achievement of certain milestones and deliveries. A Statement of Work is perceived to be a solution to potential IR35 risks by hiring self-employed individuals and freelancers. The recruiter becomes the conduit – and eliminates the client's liability for increased tax and NI.

**The Government is proposing a new employment body with powers to enforce employment rights, including for those engaged by agencies and umbrella companies. How effective do you think such a body will be in ensuring workers, particularly the lower paid, are treated fairly?**

18. We welcomed the proposal to introduce a single enforcement body, but also highlighted several issues Government has to consider before the SEB is established through primary legislation. Firstly, to meet the compliance and enforcement priorities, the three agencies must have sufficient intelligence sharing, effective collaboration and clear guidance for workers and businesses.
19. The SEB's plans to tackle issues for workers and drive compliance across the whole labour market can only be done by considering the nuisances and differences in how agency workers provide their services. We maintain that there should not be a "one size fits all" approach, especially when dealing with holiday pay and statutory sick pay issues, which is more complex for agency workers. We welcome government's commitment to providing guidance to businesses on best practice and compliment the work already carried out by ACAS.

**How successful will the draft Finance Bill proposals for earlier publication of information about promoters and avoidance schemes be in protecting individuals from being drawn into such schemes?**

20. The Government consulted on draft legislation to implement measures that give HMRC the power to close down companies involved in promoting tax avoidance. The Government is right to be taking a robust approach to those who devise, promote, or sell tax avoidance schemes. The REC welcomes this move, which will help taxpayers identify and steer clear of avoidance schemes by naming companies, including umbrella companies, which are under investigation by HMRC and controlled by promoters. However, as the legislation's main focus is on promoters and trying to change taxpayers' behaviour, this may not result in the much-needed outcome of effectively tackling tax avoidance. HMRC need more collaboration with relevant specialists to decide what further steps could be taken to prevent disguised remuneration and other tax avoidance schemes being used by employment intermediaries particularly umbrella

companies. Again, one of the most effective ways of reducing tax avoidance and improving compliance for umbrella companies is to bring them within the remit of the Employment Agency Standards Inspectorate (EASI) and they will be required to comply with Employment Agencies Act 1973 and the Conduct of Employment Agencies and Employment Businesses Regulations 2003.

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