

Federation of Small Businesses – Written evidence (OPR0026)

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. The implementation of IR35 added further friction to the labour market. This came at a time when the economy was in the midst of the pandemic and furlough was still prevalent. Now the economy is recovering, and furlough has ended, the impact of this friction is becoming clearer. Sectors which rely heavily on contract work are those facing significant vacancy issues. This has come to a breaking point with HGV drivers. According to ContractorUK, private sector IR35 reform is one of five primary factors that has added to the shortage.¹ Low margin sectors have been hit hard by the additional costs associated with complying with the newly reformed tax.

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?

2. The CEST tool should, in theory, simplify the process of identifying employment status and thus tax compliance for any individual or business that may fall within scope. HMRC's own data showed that between November 2019 and August 2021 there were 1,125,408 outcomes from the CEST tool – of this, 233,631 outcomes were undetermined. That is 20.7% of cases – one in five outcomes produced an undetermined result.² This share of undetermined status is simply too high to be effective. It leaves individuals and small businesses without clear indication of whether they need to comply with the tax.
3. We state in our report, *A Duty to Reform*,³ that the process of complying with tax should be simple and non-burdensome. The more complex the process of compliance, the greater resource drain it is on small businesses. Small businesses do not have dedicated tax teams and so resources spent on compliance when the tax is opaque means resources diverted away from productive business activities. The Government should seriously endeavour to ensure that the CEST tool improves to reduce the share of undetermined results.
4. Additionally, there have also been reports of the engager amending the criteria of the role when using the CEST tool to fit the outcome they desire and hence use the result as evidence or justification that the person being

¹ Contractor UK, IR35 reform 'fuelling 100,000 HGV driver shortage', https://www.contractoruk.com/news/0015112ir35_reform_fuelling_100000_hgv_driver_shortage.html

² <https://www.gov.uk/government/publications/check-employment-status-for-tax-cest-2019-enhancement/check-employment-status-for-tax-cest-usage-data>

³ <https://www.fsb.org.uk/resource-report/a-duty-to-reform.html>

engaged can be self-employed. The ability to manipulate the tool along with the size of undetermined results undermines its effectiveness and adds a burden to the tax compliance process.

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?

5. FSB conducted a tax survey in July 2021⁴. In this survey, we asked how small businesses view certain taxes in terms of ease of understanding, ease of working out rates and whether they thought the tax was fair. We found that 69% of small businesses said that IR35 is difficult to understand when and where the tax is applicable across their business, 66% said it was difficult to work out the rate that IR35 is paid across their business, 67% agreed that the tax itself was a particular challenge to their business, and only 10% thought the tax itself was fair. In contrast, only 39% reported that Self-employed NIC contributions were a challenge for their business and only 42% on PAYE for employees. IR35 was found to be consistently the most challenging tax for small businesses. The full findings of the survey can be found in our report: *A Duty to Reform*.⁵
6. As it stands, small businesses view the tax system as being too complex and that the number of taxes is too confusing which adds significant burdens to their business when it comes to compliance. Small businesses spend, on average, 52 hours per year completing their liabilities at a cost of £4,100 through the likes of software, accountants, and general filing processes. Scaled up, this means that small businesses are spending £25 billion a year on tax compliance – not liabilities – which could otherwise be better spent if the tax system was streamlined and simplified. IR35, as shown, is a particularly complex tax that has only increased the burden of compliance to small businesses since its introduction.
7. FSB has also had reports from members of confusion around whether they need to engage with IR35 and off-payroll taxation processes. It seems that there is a noteworthy share of small businesses that are engaging with IR35, thinking they need to comply, when they fit the exemption criteria. This comes down to the complexity of the tax.

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?

8. We have heard from our members that engagers tend not to contact HMRC on these positions, rather they go to their advisors. Engagers like the anonymous nature of the CEST tool which they then rely on to justify the positions they take. We would like to see the CEST tool strengthened in terms of its outputs so that it can be better relied upon, and for it to state clearly the risks and consequences of providing inaccurate information.

⁴ Conducted in July 2021 and received 1,000 responses.

⁵ <https://www.fsb.org.uk/resource-report/a-duty-to-reform.html>

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?

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?

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?

9. FSB has always supported fair and proportionate enforcement of labour market regulation to create a level playing field and protect the rights of employees. Unlawful practises and abuse of workers' rights should be met with tough enforcement. In parallel, we believe it is important that enforcement is accompanied by a considerable effort to provide good quality guidance and support for smaller firms to help them comply. Over the last few years, many small businesses have highlighted the adversarial approach of some agencies, such as HMRC and the Employment Agency Standards Inspectorate (EAS). HMRC focus on generating fines than on increasing compliance has a significant impact on small business owners, especially those that lack HR and wider business support. For these reasons, we believe it is important that enforcement is accompanied by a considerable effort to provide good quality guidance and support for smaller firms to help them comply.
10. In this context, a new body that will come in and lead on this area must balance and adequately address the needs of fairness for workers, the self-employed, employers/umbrella companies and others. The key will be the answers to these questions - how the body is set up; with what resources, people and powers; what structure will be put in place for it to engage properly with small businesses and the self-employed through the lead organisations here such as FSB and IPSE; and finally, how it will fit with those public employment/tax bodies that currently impact this area, as mentioned above.

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