

# **Freelancer and Contractor Services Association – Written evidence (OPR0033)**

## Executive Summary

2.1 We welcome the opportunity to submit evidence to the House of Lords Finance Bill Sub-Committee in relation to the introduction of the off-payroll rules in the private sector and how these rules are working in practice.

2.2 The first point to note is that these changes would not have been required if HMRC had adequately enforced their existing powers. It seems quite wrong that HMRC has effectively delegated its enforcement role to businesses within both the public and now the private sector.

2.3 Despite widespread campaigning for a further delay for the introduction of these changes the off-payroll regulations were introduced to the private sector in April of 2021. This was against a background of extreme pressure on businesses due to pandemic restrictions, and the UK's exit from the European Union.

2.4 A consequence of the 2017 changes in the public sector was an increase in the engagement of umbrella employers, which is an unregulated sector and therefore there are varying standards in how umbrellas operate. Compliant umbrellas are an essential part of the UK labour market. However, in 2017 the FCSA witnessed an increase in non-compliant practices and tax schemes that emerged in order to take advantage of the increase in umbrella contractors.

2.5 Whilst we cannot quantify non-compliant schemes and those firms that operate them, we are able to confirm that a similar but more sophisticated increase has occurred due to the introduction of off-payroll reforms into the private sector. FCSA reviews its Codes of Compliance on an annual basis in order to address these emerging schemes and deny operators of these schemes entry to FCSA membership.

2.6 This document will now deal with the specific questions set out in the recent call for evidence:

**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?**

2.7 The FCSA observe a number of behaviors that have emerged since and before the introduction of the private sector off-payroll changes.

2.8 The first is the emergence of some larger employers to engage managed service providers to both manage and award contracts on behalf of the end client or engager and allowing them to manage the duty of ensuring that roles/contractors are subject to testing of employment status for tax purposes.

2.9 The second is the trait of some sectors (the finance/banking sector being one) and their end clients to issue blanket bans on personal service company contractors thus potentially forcing contractors into umbrella employment in order to fulfill those contracts. This is a trend also seen in 2017.

3.0 Blanket bans, the return of highly skilled, non-UK contractors due to pandemic restrictions to their origin countries and the tougher, post Brexit UK rules on hiring foreign nationals (especially through umbrella companies) has

made it more difficult to source skilled contractors. However, this is against a backdrop of a twenty year trend towards an increasing outsourced worker sector and the recent pandemic shining a light on the fixed cost element of corporate entities, one of which is staffing. In order to become more responsive to major disruptive influences, many businesses are now looking closely at both their estate and staffing commitments which is leading to a greater reliance on temporary labour skills.

3.1 In a recent survey by FCSA member Brookson:

When asked which options they are most likely to consider if they are assessed as being inside of IR35, here are contractors' top responses:

- **59% - Seek alternative contractor work with another business, where they might be outside IR35**
- **50% - Ask for a pay increase and benefits**
- **30% - Give up contracting – it's not worth the effort**
- **21% - Challenge the decision**
- **14% - Have to downsize and cut outgoings, as this would affect their finances**
- **14% - Retire**
- **13% - Move abroad**

3.2 FCSA's most recent survey of its members (Oct 2021) demonstrates a clear shift in operating models and a growth in contractor numbers:

- **182239 contractors – this is an increase of 2% since June and an increase of 22% since March 2021**
- **Umbrella-now at 117312 -has increased by 1% since June and increased 39% since March**
- **CIS – now at 23494– has increased by 14% since June and increased 40% since March**
- **LTD/PSC- now at 41433 – has decreased by 2% since June and decreased 14% since March**

3.3 In summary, the figures drawn from FCSA companies shows a growth in overall contractor numbers, but a significant decrease in those operating via a Ltd company and a substantial increase in those operating via umbrella employment.

**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?**

3.4 HMRC's own guidance on this suggests that the CEST tool is 85% accurate (but our understanding is that this is based upon the fact that the tool gives determinations in 85% of cases and 15% state that it is a 'cannot determine' outcome. This does not support an accuracy figure) in determining employment status for tax purposes whilst a straw poll of FCSA companies suggest that this figure is in fact closer to 70%.

3.5 Other independent checks against over 20 employment tribunal cases revolving around employment status brings this figure down to around 50% accuracy.

3.6 The purpose of the CEST is to allow agencies and end hirers to assess the status of off-payroll workers. CEST will provide one of three possible outcomes. They are:

- **The intermediaries legislation does not apply to this engagement.**
- **The intermediaries legislation applies to this engagement.**
- **We are unable to determine the tax status of this engagement.**

3.7 Due to the nature of the tool, it is possible to rework results to achieve a preferred outcome. The tool is reliant upon IR35 knowledge and the honesty of the individual completing it.

3.8 By conducting a simple internet search, you are able to locate sites which undermine CEST entirely and provide you with a detailed step by step guide as to how to answer the questions in order to achieve the desired outcome.

3.9 Where you are able to amend the answers to return the desired 'Outside IR35' outcome then ultimately how dependable can the results be?

4.0 Whilst the tool is useful for obtaining an overview of the workers status it cannot be relied on as a sole judgement.

4.1 In order to successfully determine the tax status of an off-payroll worker, a review of both their contract and the day to day working practices is required. Something which CEST cannot offer.

4.2 In reviewing the working practices HMRC consider 3 principal areas, amongst others. Those are:

- **Mutuality of Obligation**
- **Supervision, Direction and Control**
- **and the right of Substitution.**

4.3 CEST clearly overlooks Mutuality of Obligation as HMRC automatically consider this is present, even when case law rebuts this presumption. This therefore casts some doubt over CEST and whether it is geared towards achieving a favourable outcome for HMRC.

4.4 HMRC have stated that they will 'Stand by the result given unless a compliance check finds the information provided isn't accurate.' This doesn't completely exonerate end-hirers as HMRC may still come to a different conclusion (as we have seen in recent case law).

4.5 One of the main criticisms of CEST is that it can identify the roles that are clearly inside or outside IR35, but often the status is undetermined, and the tool requests you contact HMRC directly via email or phone for further assistance. Our experience suggests this is difficult to do.

#### **Suggested improvements to the CEST tool**

- **It doesn't align with full case law. It should be adapting as case law via tribunal decisions dictates precedence.**

- **It still fails to consider mutuality of obligation (MOO) in its entirety. Despite putting in some new question areas HMRC still assumes that MOO automatically exists and assumes an employment contract or a contract to supply and provide work is in place to support this. This is a common area of failure in relevant tribunal cases and yet the CEST tool has yet to fully address this.**

**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?**

4.6 This is not an area that FCSA has focused on in terms of the engager and of course FCSA members have been working with off-payroll changes since 2017. However, FCSA members have had to introduce alternatives to the CEST tool in recognition that engagers may not have the skills or resources to address employment status tests.

4.7 Whilst a status determination tool is essential it can only be relied on by undertaking a simultaneous review of the contract and working practices. This means in reality that compliant umbrella companies have invested heavily in IR35 legal and tax compliance experts to ensure they are providing an accurate and reliable service to end hirers.

**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?**

4.8 The FCSA must applaud HMRC for creating a greater focus on education and guidance on issues within the outsourced sector, especially guidance for the contractor on non-compliant schemes. This also includes guidance on the CEST tool. However, the fact remains that HMRC still appears to be poorly resourced in terms of 'experts' and remains difficult to engage with unless a company has an account relationship with HMRC.

4.9 The primary challenge is that the CEST tool is regularly challenged in tribunal cases, has lost sector respect and has been overtaken by private IR35 specialists who have now filled the gap in terms of advice and support. It is also worth noting that as the new April 2021 implementation date approached, there was a widespread expectation in the sector that the date would be moved again, and a large number of smaller agencies only engaged with the legislation once it was in force.

**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?**

5.0 One of the key areas of concern for skilled contractors is the loss of income as a result of switching from PSC status to umbrella employment. We accept that end clients simply cannot increase their assignment rate by 25% to accommodate IR35 introductions to the private sector and so often, the contractor is the loser.

5.1 The FCSA has already seen a decrease in contractors operating via a Ltd company although this decline is now levelling out. When we look at contractor

forums it is clear that there is a high level of dissatisfaction with Government in terms of increased NI contributions, IR35 reforms and the removal of other tax breaks.

5.2 This is occurring at a time when skills shortages are acute, and companies and contractors are emerging from extreme financial hardship as a result of the pandemic lockdown.

5.3 In conclusion, our observation is that highly skilled contractors understand the position that their supply chain is in and are turning their anger on Government decisions and policy. However, they remain frustrated by some sectors and end clients making blanket bans in order to pre-empt any off-payroll issues.

Unsurprisingly some of this frustration has been directed at the umbrella companies some of them have started to use, and in particular at those who operate payroll properly, and pay the largest amount of tax and national insurance to HMRC. Non-compliant operators are therefore looked on more favourably by some contractors, which is why regulation in this sector is necessary, and has been for many years.

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

5.4 Please see previous answers in respect of blanket bans and managed service providers and the trends reported in the latest FCSA survey indicating growing and declining operating models. We also note, as raised at the HMRC IR35 Forum, that some businesses in the financial / banking sector have moved functions outside the UK tax territory altogether, in order to avoid having to comply with the new regulations.

**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?**

5.5 The FCSA fully support the proposal of a single enforcement body (SEB) but as it stands this is just an amalgamation of current enforcement bodies. There is a clear increase in unlawful and non-compliant practices within the sector and these far outweigh the number of prosecutions that are currently being processed.

5.6 It is therefore clear to the FCSA that it is likely that current enforcement bodies and any future SEB must be resourced beyond its current capacity and substantial funds must be found to give it the deterrent effect that is required.

5.7 Lower paid workers are more often persuaded to engage with unlawful schemes because they are offered highly plausible solutions that show how they can increase their income at a time when they are most in need of any increase in take home pay. Unless increased focus and funding is aimed at this area the FCSA is concerned that this population remains at risk.

5.8 FCSA makes two further observations:

- The criminal element that exists within the sector no longer recognises borders and so it is becoming increasingly difficult to identify and prosecute the individuals behind these schemes and remote, cloud based, or dark web IT systems make this task even more challenging for prosecuting bodies.
- FCSA very much welcome proposed regulation into the sector, having campaigned for it for over ten years. But we are concerned that it will only seek to define regulation around the umbrella model. We have always warned against this because we operate in a marketplace that is constantly evolving and developing new operating models. We cannot predict the future and so do not know how the market will operate in say three years.

5.9 We have therefore recommended to colleagues at BEIS that regulation be based around 'outsourced worker models' rather than just umbrella in order to provide universal protection to contractors regardless of the delivery model under which they work. This would give any future regulation an element of future proofing.

**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?**

6.0 FCSA observes that there has been some success in publishing the names of those companies who do not adhere to minimum wage conditions and so publication of information around providers of avoidance schemes is welcome.

6.1 But these schemes very quickly liquidate before the authorities can act and so we would recommend the public identification of both the company and the directors/owners as it is these individuals who are the common factor behind multiple companies offering such schemes.

6.2 If early publication only identifies companies, then it is likely that the company will have liquidated before publication. Whereas the directors are likely to still be active under another corporate entity.

*15 November 2021*