

Confederation of British Industry – Written evidence (OPR0038)

1. Background

1. As the UK's leading business organisation, the CBI speaks for some 190,000 businesses that together employ around a third of the private sector workforce, covering the full spectrum of business interests both by sector and by size.
2. We welcome the opportunity to submit evidence to the Sub-committee's inquiry and have been heavily engaged at all stages of the government's proposals in relation to extending off-payroll working to the private sector. This includes contributing to both the government's two previous consultations on off-payroll working in 2018 and 2019, contributing evidence to the government review of IR35 in 2020, and giving evidence before the Sub-committee in relation to its initial inquiry into off-payroll working and its "Off-Payroll Working: Treating People Fairly" report.
3. The CBI has continued to contribute from the initial consultation through to final delivery of legislation and guidance, and beyond. We welcome the Sub-committee's continued interest in this area and the opportunity to support businesses in their call for a simple and effective system of employment taxation.
4. If you have any questions or would like any further detail, please do not hesitate to get in touch.

2. Summary

1. The CBI welcomes government's and HMRC's continued interest in the impacts on businesses of the extension of the off-payroll working (**OPW**) rules to the private sector.
2. These impacts have been and continue to be substantial for many of our members in terms of financial and time cost, and loss of flexibility in the labour market, affecting engagers, agencies and contractors. While these effects are not uniform across all sectors, and there are other factors contributing to shortages in the UK labour market, the OPW rules have added yet more pressure to an already difficult labour market for business.
3. HMRC can and should do more to assist engagers and contractors to understand and correctly apply the rules, including by updating and expanding its guidance and the CEST tool to reflect the latest case law, and by clarifying when they will stand behind CEST decisions. Greater certainty could significantly reduce incorrect assessments and disputes in the system, easing some of businesses' concerns about the OPW rules.

3. Queries raised by the inquiry

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

- 1.1. Although there is variation between sectors and different sizes of business, the general consensus among CBI members who are engagers within OPW rules is that the extension of OPW to the private sector has made it more difficult to hire people with the right skills and expertise overall.
- 1.2. Certain sectors which are more likely to use contractors – including driving and logistics, defence and security, construction, and information technology – or areas of services where contracting models were more common – such as professional and media services – were highlighted as suffering particular problems.
- 1.3. The most common reasons cited for concern include:
 - 1.3.1. The departure of contractors from the labour market, whether through retirement or departure from the UK. Members have experience with contractors specifically citing the changes in the OPW rules as the reason for their departure.
 - 1.3.2. The small companies' exemption from OPW, while welcomed by some members, has caused a distortive effect in sectors where both small and larger businesses operate as engagers, because some contractors are choosing to engage only with small companies outside the rules. In areas with limited pools of suitable talent – particularly in technology – this has given smaller engagers a competitive advantage over their larger competitors.
 - 1.3.3. The additional compliance burden involved in the initial recruitment process and disputes arising from Status Determination Statements (**SDS**) discourages some businesses from hiring contractors - and discourages contractors from making themselves available - for short-term or temporary contracts, causing a loss of flexibility in the labour market. A member noted that the vacancy rate across temporary contracts was significantly higher than for permanent vacancies (which had itself increased by 5% since the OPW rules were extended to the private sector).
- 1.4. Business recognises that there are other pressures in the UK labour market, some of which have coincided with the extension of OPW to the private sector. These include a need for additional skills training in certain sectors (such as technology and construction), the effects of the UK's exit from the European Union and the COVID pandemic. There is therefore more work to be done to understand the extent to which OPW has contributed to current labour market shortages in certain areas. However, there is no doubt that it has been an additional contributing factor for affected sectors and businesses, and has added to an already difficult period in the UK labour market.

2. 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?

- 2.1. The CBI appreciates the work that has been done to make amendments to CEST to better reflect the needs of business and the relevant employment law tests. The CBI also welcomes HMRC's efforts to provide certainty to

business with their confirmation (repeated in their recent [guidance of 23 September 2021](#)) that HMRC will stand behind the outcome from the tool.

2.2. However, this confirmation is limited to where the information entered is accurate, remains accurate, and is used in accordance with HMRC guidance. The CEST tool continues to cause issues for businesses seeking to use it, in large part because the tests required to determine whether a contractor falls inside or outside the rules are derived from complex and regularly changing case law, and the CEST tool (as well as the HMRC guidance that underlies it) does not reflect the complexity of this case law, so engagers and contractors are not able to be sure that the information provided is fully accurate. In addition, if the intention of HMRC's requirement that the information 'remains accurate' is that engagers should not only check contracts on commencement, but also continuously review all their existing contracts, the compliance burden for engagers would be unreasonably high. There are also cases where HMRC guidance is in conflict with case law or has not been updated to reflect the latest developments, so that relying on HMRC guidance may not provide a definitive outcome.

2.3. Specific technical concerns raised by members include:

2.3.1. The approach to "mutuality of obligation" (i.e. the extent to which the engager is obliged to provide work to the contractor, and the contractor is obliged to accept work provided by the engager) in both HMRC guidance¹ and the CEST tool is over-simplified. Case law in this area supports the view that the concept of mutuality of obligation for employment law purposes is not directly analogous with the principle that a contract establishes legally enforceable obligations between the contractual parties and HMRC could do more to update their guidance to reflect the case law in this regard.

2.3.2. When considering "control"² (i.e. the extent to which an engager controls the activities of the contractor while carrying out their duties under the contract), the CEST questions do not reflect the reality of modern flexible working. This is a particular issue in cases of home working (a trend which was already popular in some sectors, like IT, has increased dramatically as a result of the COVID pandemic and is expected to continue). Further reflection on the impact of location of working is needed both in HMRC's guidance and via the CEST tool.

2.3.3. When considering financial risk allocation³ (i.e. the extent to which financial risk for the work undertaken, and any costs associated with it, are taken by the engager or the contractor - which is one factor that can be used to determine whether contract falls within or outside the OPW rules) the CEST questions suggest it is the timing of payment chronologically, rather than the likelihood of recovery (and therefore the allocation of risk) which is being tested.

¹ HMRC's Employment Status Manual discusses HMRC's understanding of what constitutes 'mutuality of obligation' at [ESM0543](#).

² HMRC's Employment Status Manual discusses HMRC's understanding of what constitutes 'control' from [ESM0516](#) to [ESM0529](#).

³ HMRC's Employment Status Manual discusses HMRC's understanding of what constitutes 'financial risk' at [ESM0541](#) and how that should be applied within the CEST tool at [ESM11085](#).

- 2.4. While members recognise the value in having the CEST tool, these interpretative issues contribute to lack of clarity for engagers and contractors as to their status, additional compliance costs (as more time and money is spent on internal training, and either creating internal tools or seeking out and purchasing third party tools and advice, to deal with complex cases or fill the gaps in guidance), and an increased rate of disputed SDSs.
- 2.5. The CBI would like to see further guarantees from HMRC that they will continue to update their guidance and the CEST tool in accordance with case law, and that they will seek to expand on this guidance to assist business and contractors to understand and determine contracts appropriately.

3. 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?

- 3.1. The changes and costs to business of the OPW rules can be divided broadly into two categories: initial set up costs and ongoing compliance costs. As we are only in the first year of the OPW rules in the private sector, members are currently transitioning from concerns arising mainly from initial set up costs (in terms of both time and money) to the longer-term issue of ongoing compliance costs.
- 3.2. Business have taken a variety of different approaches to the introduction of the OPW rules, depending on the size and impact on their business and the additional risk and costs to them. Some members have chosen to limit their engagement through personal service companies (**PSCs**) entirely. While this may limit their costs relatively, they have still incurred initial costs in, for example, identifying and terminating existing agreements with PSC contractors, renegotiating terms where such contractors were willing to reengage on PAYE terms or recruiting replacement personnel where they were not, and reviewing and amending supply chain terms to ensure that no services are being delivered by PSC subcontractors of larger suppliers. For larger organisations with numerous suppliers this work has been extensive. This approach has also limited such members' access to the labour market, often in areas with high demand and has generally led to increased cost for the PAYE engagements they do enter into compared to a contractor relationship.
- 3.3. Many businesses which engage contractors on a large scale are not in a position to take this approach, so have faced substantial initial set up costs and are and will continue to face ongoing compliance costs. Initial set up costs include hiring and/or training staff to manage the initial review of contracts (including disputes arising from initial assessments), amending and updating VAT, payroll and other compliance systems to reflect the new types of contracts that will be managed, and training for all hiring managers and more widely across the business on the new rules.
- 3.4. Ongoing compliance costs including reviewing all new hiring arrangements, dealing with disputes arising, and reviewing existing contracts as and when HMRC guidance and case law changes.
- 3.5. Most members agree the compliance costs have been significant, and that HMRC's initial estimate of the upfront cost to business of £14.4m (spread

across 60,000 engagers and 20,000 recruitment agencies) was a gross underestimate when HMRC also required engagers to consider each case individually and make a determination on a just and reasonable basis.

4. 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?

4.1. The CBI appreciates the support provided to businesses over the last three years, and members particularly noted that HMRC have worked to achieve greater public understanding of the OPW rules through a series of webinars on the subject.

4.2. However, engagers have experienced a lack of proactive engagement from HMRC directly with them on the topic – even where they have a customer compliance manager (**CCM**) – and there is widespread concern that contractors and smaller businesses without access to experienced employment law advisers have not had enough support. This in turn is contributing to incorrect assessments, and unnecessary disputes between engagers and contractors.

4.3. Engagers would also appreciate more support in establishing their internal compliance systems. While some are relying only on CEST, many have had to purchase third party tools and advice on the application of the rules to their business. Without greater support and guidance from HMRC, businesses which do not have the available resources to bring in third party support are more likely to make incorrect assessments.

5. 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?

5.1. With the extension of OPW rules to the private sector, the burden for resolving disputes as to status shifted substantially from the contractor and tax authority to engagers, which are required to prepare the initial SDS and to provide dispute resolution when an SDS is appealed. It is not surprising, therefore, that engagers have seen a substantial increase in disputes with contractors.

5.2. These disputes can arise at every stage of the engagement process and in different forms: some former engagers chose not to engage PSCs going forward at all (thus limiting the number of disputes arising, but not eliminating them – particularly where they are end users in a supply chain which may still use PSC contractors – and restricting their labour market access); others have found an increasing number of contractors walking away from contracts after offer because the SDS confirms that that they would fall within the OPW rules, or seeking to renegotiate their rates to cover increased PAYE costs without reducing their net position, even if they accept the determination.

5.3. Businesses have not generally found that having an engager-lead resolution process has deterred contractors from raising disputes. One member which is an engager confirmed that contractor disputes (rather than any other stage of the contractor hiring process) take up the majority of the

relevant team's time. Another, on reviewing several thousand contractor contracts, saw a 30% appeal rate against SDSs.

6. 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?

6.1. The behavioural effects of the introduction of the OPW rules to the private sector are varied, depending on the extent to which businesses engage contractors and how flexible their options are in their sector.

6.2. As described above, a small proportion of businesses have taken the decision to hire only through PAYE engagements. Others continue to hire contractors but while operating in a much more challenging and complex compliance environment.

6.3. The CBI is also aware of behavioural effects on some:

6.3.1. employment agencies, which are seeking to broaden and restructure their offer beyond labour to allow them to be treated as providing fully outsourced services; and

6.3.2. contractors, who may be seeking to rely on umbrella companies to a much greater extent than previously.

6.4. While these behavioural effects are not problematic perse, there are growing concerns (which we understand are shared by HMRC) about the role of umbrella companies in the employment chain and ensuring their arrangements are also fully compliant with employment and tax law and guidance.

7. 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?

7.1. The CBI welcomes efforts from government to better coordinate and manage employee rights regulation. In the context of the OPW rules, members are supportive of the move to regulate umbrella companies as a part of this process. It is essential that any new enforcement body has the resources and specialist skill required to fully understand the complexities of the OPW rules as they apply to the private sector and apply regulation fairly, consistently and in full coordination with HMRC.

8. 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?

8.1. The CBI has not responded to question 8 of the consultation as it is applicable primarily to individuals rather than business.

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