

**Submission to
The House of Lords Finance Bill Sub-Committee**

Concerning the UK Government's proposal to extend the 'off-payroll working rules' to the private sector

23 February 2020

1. Overview

The UK government should not extend the 'off payroll' rules to the private sector. Such an extension will in our view and experience:

- Significantly and adversely impact upon entrepreneurial activity in the UK.
- Result in major UK jobs losses in the self-employed sector.
- Create further abuse of self-employed people by the UK tax administrator.
- Damage the UK economy.
- Result in tax revenue loss to the UK government from job losses and lower entrepreneurial activity.

Since 2000, HMRC has tried to solve a perceived tax equity and revenue 'problem' through an incompetently conceived process (IR35) that has been incompetently administered. When IR35 failed, HMRC layered further incompetency upon incompetency resulting in the current 'prescription' of the off-payroll rules.

HMRC has failed to understand the natural market response to its policies which have attempted to force the round peg of modern societies' entrepreneurial endeavours into HMRC's 1950s square hole of tax administrative preferences. Whenever HMRC has attempted a rigid 'fix', the market has responded and stepped around the fix. This has been going on for 20 years.

After 20 years it should be recognized that that the 'problem' does not lie with self-employed people but with a failed HMRC.

2. Why Self-Employed Australia (SEA) makes this submission

SEA is a small business advocacy group in Australia dedicated to defending the rights of self-employed people. A primary focus of our advocacy since our formation in 2000 has been and continues to be the treatment of self-employed, small business people by tax administrators. Our natural focus is the Australian Taxation Office (ATO).

But our interest extends beyond the ATO, particularly to jurisdictions with legal histories and systems similar to Australia's. This includes the United Kingdom, the United States and Canada for example. The reason for our global interest is that the thinking on tax administration is actively shared by global tax administrators. The UK and Australian tax authorities have a particularly close association through the [formal global enforcement programs](#) and [the J5 network](#) for example.

It is our experience that tax administration approaches and policies in the UK, for example, can and often do have significant influence on tax administration in Australia. Further, our interest in defending the rights of self-employed people is not restricted to Australia. We are also offended and concerned when we see self-employed people in other jurisdictions treated unjustly, even abused, particularly by government authorities. We are drawn to make comment where we feel we have some factual perspective to offer.

In relation to off-payroll matters, the issues run parallel to the debate and policies in Australia around the tax treatment of the self-employed. In 2000, a major Australian policy review occurred in relation to the question of the tax treatment of personal income earned through entities (proprietary limited companies, trusts and partnerships). This is the core issue underpinning IR35 and 'off-payroll', but also extends to sole traders.

In 2001, Australia's 'solution' was the [Personal Service Income Tax laws](#). These laws are not perfect from the perspective of the self-employed, but their implementation and application has result in some degree of clarity. Certainly the huge problems that the UK witnessed with IR35 and subsequent 'fixes' have not been experienced in Australia

3. Background: the rise of self-employment in the UK

The number of self-employed in the UK has increased from

- 3.3 million people (12.0 per cent of the labour force) in 2001 to
- 4.8 million people (15.1 per cent of the labour force) in 2017.

[Source: Office for National Statistics (UK)]

The rise in UK self-employment makes up for almost all of the drop in UK unemployment since 2001:

- 5.1 per cent unemployed in 2001 to
- 4.0 per cent unemployed in 2018.

[Source: Statista]

Even with the growth of self-employed numbers in the UK, this percentage is still below that of Australia where the self-employed rate was 17.1 per cent of the workforce in 2016.

The actual number of self-employed in Australia has remained stable at approximately 2 million for around a decade.

When compared with Australia, the UK has considerable potential for further major growth in the self-employed sector.

We submit that the implementation of off-payroll rules to the private sector threatens the capacity of the self-employed sector to continue to grow and continue to contribute to the lowering of unemployment in the UK. In fact, applying the off-payroll tax rules to the private sector should result in a significant drop in UK self-employment and hence an increase in UK unemployment.

4. Background: Clarifying how the UK tax system applies to the self-employed

Our understanding is that in the UK similar personal income tax rates apply whether a person is employed or self-employed. However, the UK also imposes National Insurance (NI) contributions on top of income taxes.

Payment of NI contributions builds up entitlements to social security benefits such as the state pension, unemployment and maternity allowances.

NI contributions have two parts:

- First, whether someone is an employee or self-employed they pay NI at similar rates. In the case of employees, the employer withholds the employees' NI contributions and sends them to the tax authority. Self-employed people remit NI contributions themselves. Self-employed people who use limited companies don't pay NI, but the increased taxes they pay on dividends effectively claws this back.

But

- Second, employers must also pay an additional "employers' NI" on their employees of 13.8 per cent. Businesses, however, do not pay the additional NI when they engage self-employed people. *It is this that is the source of so much contention.*

5. HMRC says that the self-employed create revenue losses in the UK

HMRC has long held the view that the self-employed create significant revenue losses through the non-collection of the additional 13.8 per cent NI. But the fact is that the losses occur largely because the engaging businesses do not pay the additional NI when engaging the self-employed. That is, the revenue losses occur because businesses legally avoid paying any additional NI. It is not the self-employed that are avoiding the additional NI but the companies that engage the self-employed.

There is nothing wrong with this. No one is illegally avoiding the NI. The law is quite clear and, for whatever reason, historically the UK Parliament passed such laws. The 'problem'

lies not with the self-employed or the engaging businesses. The ‘problem’ is a result of legislative intent.

To repeat, the revenue losses occur because businesses legally avoid paying additional NI. It is not the self-employed that are avoiding the additional NI but the companies that engage the self-employed. This simple core fact seems to have been ignored in the UK debate. HMRC has certainly chosen to ignore this fact.

6. HMRC efforts to ‘solve’ the ‘problem’

HMRC have instead taken it upon themselves to declare a ‘problem’ of revenue loss and have blamed the self-employed for the problem.

HMRC has sought to ‘solve’ the problem of revenue loss principally by attacking the self-employed, declaring them to be “deemed employees”. HMRC have demonized the self-employed as tax avoiders and have effectively waged bureaucratic ‘war’ against the UK’s self-employed.

Again, to repeat, HMRC does this while ignoring the real source of the ‘problem’—the law that allows the avoidance of the NI by engaging businesses.

But HMRC’s efforts have become very messy, distorting the economy as described below.

7. IR35 (2000)

In 2000, HMRC induced the government to introduce the Intermediaries Legislation, commonly called “IR35”, to address the ‘problem’. IR35 effectively pushed the cost of the employers’ NI on to the self-employed, massively increasing the taxes paid by the self-employed.

IR35 has been hugely controversial and ineffective. IR35 cases have been challenged in the courts, with **HMRC losing about 90 per cent of the cases in modern times**. That is, HMRC have been consistently incompetent in undertaking common law assessments of self-employed status.

HMRC therefore looked for another ‘solution’.

8. Public Sector (2017)

In 2017, HMRC induced the government to introduce new legislation for the public sector that forced government-sector hirers of self-employed people to assess the status of individuals to see if they were “deemed employees”. In other words, because HMRC had failed to competently administer common law tests of self-employment they transferred that task to other public-sector managers. This is HMRC dodging their responsibility for tax administration.

In the process of avoiding their responsibility, HMRC created an online tool (CEST – Check Employment Status for Tax) through which hirers could allegedly assess whether the people they hired were self-employed or “employed for tax purposes”. By answering just 16 questions, HMRC sought to impose NI on the self-employed in cases where HMRC said that the CEST tool found a person to be an employee.

Many experts have been highly critical of CEST, claiming it to be heavily biased and prone to giving inaccurate results. We, likewise are heavily critical of CEST. The very idea that bureaucrats can design an online questionnaire that successfully predicts what a court decision would be on a specific case is public sector arrogance of the highest order. CEST is not legally binding and even HMRC’s own legal counsel have admitted in court that it is ‘irrelevant’. HMRC claim that it is for guidance only, but it almost always requires public-sector bodies to use it. In fact, CEST is an HMRC intimidation tool.

By requiring organisations to use CEST, HMRC hopes to bludgeon organisations into falling into the HMRC prescriptive design. HMRC must know, we submit, that the expense and brand damage to businesses of not relying on CEST would and will cause businesses to follow HMRC’s view of the world.

In the public sector, organisations used CEST to check whether an engaged person was self-employed or an employee. If the person was an employee, the public-sector organisation then had to pay the employer’s NI. Many organisations imposed blanket rules declaring the self-employed to be “deemed employees”.

The consequence/reactions were as follows:

- a) People assessed as employees: Public-sector organisations which assessed self-employed people as employees then insisted that the workers’ remuneration be reduced to cover their employers’ new NI tax bill. This resulted in major desertions of self-employed people from the public sector.
- b) Tax avoidance schemes: Some public-sector organisations then encouraged self-employed people to seek engagement through third-party (mostly offshore) labour hire companies that used creative schemes to reduce tax. This resulted in the creation of potential tax cheats and tax losses for HMRC.
- c) Third party engagement: Some organisations stopped hiring contractors directly, or through agencies, and instead approached larger consultancies in order to circumvent the need to assess. But this had the adverse effect of forcing organisations to pay considerably more to access the same skills.
- d) The areas of the public sector negatively affected by this have primarily been in information technology and systems design/support, but the National Health Service (NHS) and the BBC have also been affected, along with major rail infrastructure projects such as High Speed 2. The NHS has lost doctors, nurses and other key health professionals.

Surveys have shown that

- e) 50 per cent of public-sector hiring managers had lost skilled contractors as a direct result of the changes to IR35 regulations.

- f) 70 per cent of hiring managers said that they were now struggling to hold on to their contractors in the public sector.
- g) 52 per cent said they had witnessed cost rises, delays and even project cancellations.

The stupidity of this HMRC approach however is glaring. Where HMRC gain additional tax revenue from public sector organisations the additional revenue is entirely offset by higher costs of the public sector organisations. The net result is zero additional money in government coffers.

9. *Loan schemes through third parties*

Part of the fallout from the Public Sector ruling was that third parties promoted tax avoidance ‘loan’ schemes to the self-employed. These were legal, HMRC knew about such schemes and public-sector organisations encouraged people to go on to such schemes.

Public-sector organisations engaged the self-employed through a third party. The third party would ‘lend’ money to the self-employed (which was never to be repaid) and the self-employed person’s taxable income was then lower, reducing or eliminating the additional NI liability (that was really the liability of the public-sector organisation).

What followed was that:

- Thousands of public-sector workers were incorrectly assessed as ‘employed for tax purposes’.
- There was no appeals process (other than an expensive court case).
- It incentivised the widespread adoption of the loan tax-avoidance schemes.

Effectively, the “employer’s” NI obligation was transferred to the self-employed workers who sought ways to overcome paying tax rates that were significantly higher than those of employees.

HMRC has subsequently clamped down on the loan schemes.

- It is estimated that up to 100,000 workers have unwittingly been seduced into tax-avoidance payroll schemes. These individuals are now exposed to substantial tax risk, with many reporting they will need to go bankrupt. These individuals are ordinary people. They do not have the resources of large organisations to defend their rights or fight back against HMRCs incompetency and abuse. These ordinary people suffer personally.

For example:

- A locum GP says HMRC has demanded £120,000 from her and that she will have to sell her house. This in spite of the NHS requiring her to be on the books of an agency.
- Another person had to pay £180,000 and his family are now living in a two-bedroom council flat. He is also facing demands for more than £95,000, a charge for back-tax for a year during which he hadn’t even worked.

10. Extending the Public Sector Rule to the Private Sector

HMRC has pitched the problem as “off-payroll reform” and earmarked April 2020 as the date to extend the public-sector rules into the private sector.

HMRC estimates that, in total, about 500,000 workers are targeted, but says that around 170,000 are not legitimately self-employed. It defies common sense that HMRC is able to accurately predict the numbers of ‘illegitimate’ self-employed. HMRC has consistently been proven to be wrong in the courts on the self-employment test. It should be assumed that the HMRC figure is a wild guess intended as a public relation pitch to support its desire to extend the rules to the private sector.

11. Summary

This is a study of a mindless tax bureaucracy which is incapable of properly thinking through an issue.

- The central problem is that the law allows businesses/engagers to avoid paying additional NI obligations by engaging self-employed people.
- Instead of fixing this HMRC has chosen to attack self-employed people by pushing the business/engagers’ NI obligations on to the self-employed.
- Self-employed people then end up paying more tax than employees and it is unsurprising that the self-employed have looked for ways to not pay the extra tax.

Further

- In trying to resolve the problem through the method of forcing self-employed people into being employees, HMRC thought that it could impose its will through the public sector.
- This meant that HMRC imposed additional costs on the public sector in order to raise more revenue. But the additional revenue was simply lost in the additional costs. It was and is a case of the revenue dog ‘chasing its tail’-a massive expense of energy for no net revenue outcome!
- The consequence however is major disruption/dysfunction within public-sector organisations and reduced service capacity—for example in the NHS.

Please excuse our cynicism but it could be taken that HMRC approached Monty Python script writers in the design of this public sector policy. If it were not for the harm imposed on self-employed people, the public sectors’ performance and the UK economy, the HMRCs behaviour would truly be a comedy.

12. Conclusion and recommendation

The behaviour of HMRC demonstrates an obsession in tax administration circles with the view that the self-employed somehow ‘rip off’ the tax system. This is in spite of the evidence that the revenue loss is a result of a failure to close a tax loophole that allows engaging businesses to avoid paying additional tax obligations.

Since 2000 HMRC has tried to ‘fix’ the issue by forcing self-employed people to be employees. This has at all times failed, created significant distortions to economic activity and caused individual harm to large numbers of self-employed people.

The sequence of events described above, over 20 years, demonstrates the incompetence of HMRC to design and apply tax administration fitted to the modern entrepreneurial world of self-employment so essential not only to the UK economy but to the global economy as well.

The experience of the off-payroll tax rules being applied to the public sector will predictably be repeated in the private sector. Our observations cited in 8(a) to 8(g) (above) will reoccur in the private sector. But this time, instead of the additional money received by HMRC being offset against high public-sector costs, the damage to the UK economy will be real. There will be major distortions to economic activity in the UK.

We repeat our view stated at the beginning of this submission.

The UK government should not extend the ‘off-payroll’ rules to the private sector. Given the lessons from the past 20 years such an extension will:

- Significantly and adversely impact upon entrepreneurial activity in the UK.
- Result in major UK jobs losses in the self-employed sector.
- Create further abuse of self-employed people by the UK tax administrator.
- Damage the UK economy.
- Result in tax revenue loss to the UK government from job losses and lower entrepreneurial activity.