

IPD Employment Status and Intermediaries Policy,
Room 3/46, 100 Parliament Street,
London SW1A 2BQ

10th August 2018

FSB response to the off-payroll working in the private sector consultation

The Federation of Small Businesses (FSB) welcomes the opportunity to respond to the off-payroll working in the private sector consultation.

FSB is the UK's leading business organisation. It exists to protect and promote the interests of smaller businesses and the self-employed. FSB is non-party political, and with around 165,000 members, it is the largest organisation representing small and medium-sized businesses in the UK.

Small businesses – those with less than 50 employees - make up 99.3 per cent of all businesses in the UK. Medium-sized businesses are another 0.6 per cent of the businesses in the economy. SMEs therefore are 99.9% of all businesses in the UK, and make a huge contribution to the economy. They contribute 51 per cent of private sector output, amounting to £1.9 trillion annually, and employ 60 per cent of the private sector workforce.

FSB believes IR35 reform threatens to blunt one of the economy's key features at just the time they are needed most.

Government should be reconsidering plans to expand reforms of IR35 to private sector. Any reforms should be given an extended lead in time and not coincide with seismic changes such as Brexit. Small businesses should also get specific consideration as they will struggle to adjust to the reforms even more so than the public sector

UK's flexible labour market

The UK has one of the most flexible labour markets in the world. This flexibility has undoubtedly contributed to the UK's record low unemployment rates. This flexibility will be essential in supporting the UK economy to succeed post Brexit.

Importance of contractors to small businesses

Small businesses often rely on the expertise of contractors. They allow small businesses to bring on board expertise on a flexible basis. As small businesses are often very responsive to changing demand, it can often be too great a risk to recruit full time employees to address the resourcing needs of single projects. Conversely, contractors provide the flexibility that small businesses need if there are fluctuations in demand.

This flexibility is vital for the productivity of the economy and small businesses especially. Research by Professor Andrew Burke shows small businesses would find

growth and innovation harder to accomplish without the skills and flexibility that contractors provide¹.

Contractors are also able to bring unique knowledge to the labour market. They are able to take the same expertise to a number of different businesses, often of different sizes and within different sectors. This creates individuals with the rare mix of highly refined skills and varied experience.

Small businesses with limited resources often rely on highly-skilled contractors to deliver the necessary resource to fulfil client requests on an adhoc basis.

The priority must be to ensure that businesses are still able to easily access the expertise of contractors.

Administrative burden

Administrative burdens are already seen as one of the main barriers to small business success. These firms often spend their limited time and cash adhering to regulations that were designed with larger businesses in mind.

Most small businesses do not have the dedicated Human Resources, legal and financial staff that are necessary to accurately implement complex legislation such as IR35.

The success of IR35 reforms in the public sector are at least in part because well-resourced government departments were able to manage the adjustments. And this success is heavily disputed. It is only reasonable to expect the process to be much more painful across the private sector, especially among smaller businesses.

Transferring the responsibility from contractors to small businesses will add to determine whether contractors are inside or outside of IR35 will only add existing administrative burdens. A very steep learning curve would be required to understand and apply the legislation correctly.

Additionally, asking small businesses to adhere to these rules while at the same time expecting them to meet Making Tax Digital obligations (for VAT) and prepare for Brexit (including a potential no deal scenario), will be put a massive strain on them. For some small business owners all of these simultaneous changes may prove too much.

The reforms will also come at a time when the sufficient supply of labour is likely to become a more acute problem. If EU foreign labour becomes less readily available to UK small businesses post Brexit, they will become ever more reliant on contractors to fill vacancies. IR35 reform in the private sector will cause greater skill shortages at precisely the wrong time.

For these reasons, FSB believes **the Government should be delaying changes in the IR35 rules for small businesses with under 50 staff**. This will give more time for the CEST tool to be refined and hopefully make compliance for small businesses easier.

Issues with the CEST tool

¹ Burke and Cowling, 2015, The Use and Value of Freelancers: The Perspective of Managers, The Handbook of Research on Freelancing and Self-Employment. Chapter 1: pp. 1-14., Senate Hall Academic Publishing <http://www.crse.co.uk/sites/default/files/The%20Use%20and%20Value%20of%20Freelancers.pdf>

The CEST tool is likely to add to a small business' administrative burden. The current means of deciding employment status within businesses is not reliable. There have been reports that the tool does not align with court judgements and, in a large proportion of cases, provides an undetermined result.

For small businesses this adds a layer of complexity to an already difficult process without providing a reliable solution.

Another problem with the CEST tool is that it is not transparent. It is a single route questionnaire where at certain points the test will give a result. FSB believes that the result of the test should only be given once all questions are answered as the entirety of factors that determine the nature of the engagement should be considered holistically and should, importantly, consider mutuality of obligation.

Overall FSB's concern is that rushing to adopt IR35 legislation within the private sector may do more harm than good to small businesses and the wider economy. The Government should be delaying any plans to expand the rules to the private sector until businesses express confidence in the tool and have a clear understanding of the rules. The treats of increased admin and employment costs, as rates for contractors are driven up, are too great at this point.

In particular the legislation poses a threat to small businesses. The Government should consider a longer timetable for implementation for smaller businesses. Doing so is particularly crucial because of the many other changes that small businesses are expected to adapt to within the coming months. Each of these changes will bring their own administrative burdens and opportunity efficiency costs, in the short-term at least. Allowing small businesses more time to adjust is therefore the most prudent approach.

Thank you for considering our response to this consultation. We hope it is found to be useful. If you would like to discuss any of the points further, please contact me via my colleague Lorence Nye, Policy Advisor, on 020 7592 8126 or Lorence.nye@fsb.org.uk.

Yours sincerely,



Tony Baron

Chairman of the Finance, Tax & Economy Committee

Federation of Small Businesses

ANSWERS TO CONSULTATION QUESTIONS

Q1. What could be done to improve the compliance enquiry process to reduce noncompliance, whilst safeguarding the rights of customers?

FSB is concerned about the prospect of applying IR35 public sector rule changes to the private sector. The changes in the public sector have only been analysed for 10 months: this is not enough time to make an accurate prediction of their impacts on the vastly more complicated private sector.

Instead a full, comprehensive, independent review should be conducted after the conclusion of the tax year 2018/19.

Analysis of the reviews findings should consider that applying these changes to the private sector will hit many businesses that are less capable of understanding and adjusting to the complex IR35 rules than public sector bodies.

It is essential that the liability question is reviewed. It may not be appropriate that the recruitment agencies, who may not have the best understanding of the actual nature of the working relationships they assess, have liability for assigning status and unpaid tax.

FSB believes that government should exempt smaller businesses from IR35 reforms as they will struggle more than larger businesses to adjust to the changes. Small firms typically do not have HR, legal and finance advisors in-house. If the reforms solely affect larger businesses in the first instance, it will allow an opportunity for their impacts to be understood and next steps to be planned carefully.

CEST

The CEST system does not provide enough clarity. Through our own testing FSB has found the system is currently only able to give a decisive answer in around 8 in 10 cases. FSB believes this does not give small business enough. If 20% of the time business owners have to reassess the nature of an engagement, it will add an extra barrier to bringing-in expertise.

There are also reports that the tool has actually produced results that run contrary to recent courts decisions.

The current system provides a result at different points during the questionnaire. This creates an opaque, roulette-style process. Engagements between firms and contractors need to be considered holistically. While certain features of an engagement can strongly indicate employment status, the system less fair and clear cannot work effectively if the test is completed at different stages by different individuals.

The CEST system therefore needs to be adjusted. Firstly, it should allow a full questionnaire to be completed in all cases and provide a breakdown of how the responses drove the result.

Secondly, there needs to be an understanding of why the system diverges from some recent court decisions, and if that is its intention. Small business owners that are looking to bring in contractors are likely to take a view of how their engagement will be assessed based on advice and their interpretation of prior decisions. If the tool is not consistent with this then they may be put off the process altogether and either hire a more costly full time employee or, an even worse prospect, not expand their business at all.

Finally the test should consider the significance of obligation. Perhaps Mutuality of Obligation has become a dated test as often the engager has no obligation to the contractor in the modern economy.

Both elements of the mutuality principle can still be tested.

If, for example, the willingness to accept work impacts upon future access to work, the contractor is indeed under some obligation to provide their personal service. This test should be present in the CEST.

There should also be a test of long term assurance of future work from engager to contractor.

Q2. Could the public sector regime better fit the needs of businesses? How?

The public sector IR35 regime stipulates that recruitment agencies are liable for unpaid NICs. FSB believes this should not be the case and end clients should instead be liable. Making recruitment agencies liable might result in them being reluctant to facilitate the supply of workers to firms.

FSB is against shifting liability from the individual contractor: to assign it to agencies in the private sector would be particularly problematic and causes additional complication. The "fragmentation of responsibilities" example in the consultation regarding two agencies might be replicated if there is a disagreement between agency and end user about what tax should be applied to an engagement.

Q3. What if any, changes could help make the administration as simple as possible?

As mentioned earlier, (see answer to question 1) the CEST tool needs to be refined in order to be more effective.

Q4. If the private sector rules were changed, do you have any evidence that there are parts of the private sector where the administration of any regime may need to vary even though the basic principles including for determining status, remain the same?

As stated above, FSB believes the legislation should exempt small businesses as defined as those that employ less than 50 full time employees.

Q5. Is there any evidence that parts of the private sector will not have, or be able to acquire the administrative capacity, knowledge and resources to enable them to implement any changes in relation to off-payroll workers?

FSB believes that the Government should excluding small businesses from any change to IR35 rules in the private sector. FSB believes that smaller businesses are likely to struggle to comply with any change in rules.

Without HR, legal and finance departments or professionals in-house, many will not be capable of understanding the complexities of the intermediaries legislation and how to apply it to an engagement.

The current CEST process is opaque. It regularly produces undetermined results and results that contradict court rulings.

Q6. How could these difficulties be mitigated?

FSB believes that while the CEST tool needs reform the Government should delay roll-out of any potential changes to the IR35 rules for small businesses.

FSB is not of the belief that this would create large shifts in behaviour. It is unlikely that contractors would solely choose to work with smaller businesses simply because they have been exempted from any new changes. According to HMRC's review, the discrepancy in the rules that has existed between public and private sectors has not driven behaviour to a significant extent.

Q7. What aspects of policy design might be adjusted if similar changes were brought in for the private sector? Should we bring in a specific penalty if agencies fail to comply?

FSB does not believe agencies should be the target of the legislation. Rather, end clients should be the focus.

Q8. What action should be taken in the case where the fee-payer hasn't acted upon the client's conclusion that the worker would have been regarded as an employee for income tax and NICs purposes if engaged directly? Should an obligation be placed upon the fee-payer to adopt the client's conclusion and there be sanctions for failing to do so?

Theoretically, in this instance the liability should be assigned to the agency. However, FSB believes that this is one of the main issues with how IR35 works in the public sector. It is clear that the end client is most likely to have the best understanding of the true working relationship between themselves and PSCs.

If the agency does not have liability for paying the correct tax they will not have the incentive to ignore the end client's instructions. The system therefore should be adjusted so that the fee paid to the agency from an end-client can be accurately extracted for tax purposes.

Q9. What action should be taken if the worker or PSC is knowingly receiving income that has not had the right amount of tax and NICs deducted?

If the responsibility for assigning status is given to the end client then they should be responsible for unpaid NICs.

To be clear, employee NICs would be due from the end client, unless it can be demonstrated that the PSC was in receipt of higher payment due to NICs not being withdrawn before payment. Some evidence of collusion should be necessary to shift some of the liability to the PSC.

FSB believes this approach properly safeguards PSCs that accept self-employed engagement because of the requirements of their client.

Q10. What systems and process changes would businesses need to make?

Businesses will have to ensure that the person in charge of the HR process understands IR35 legislation and how the CEST tool works.

Q11. Would there be any process and administrative cost implications for businesses? Can you provide evidence of the scale and nature of these?

FSB believes that there is likely to be significant costs associated with the reforms to IR35. Smaller businesses already cite employment costs as rising generally and the administration of increased pension responsibilities is costly.

Q12. Can you provide any evidence that these costs would vary depending on how much notice businesses were provided for the introduction of any reform?

More time would allow for more efficient processes to be prepared.

Q13. Is there anything else HMRC could do to ease the implementation for businesses, and can you provide evidence of how this would ease implementation or administration for businesses?

FSB believes small businesses will need more time and additional guidance.

Q14. Overall, what are your views on this option? Would it be a proportionate response to the issue?

FSB believe the encouraging or requiring businesses to secure their labour supply chains solution would result in an untenable administrative burden for small businesses.

For that reason we believe it is a unsuitable solution.

Q32. Are there other options, within the scope of this consultation as set out in Chapter 2, that would be effective ways of tackling non-compliance in the private sector that the government should consider (for example, possibly drawing on lessons from other countries)?

Additional record keeping might also create unbearable administrative burden for small businesses. FSB does not believe this is a workable solution either.

Q34. Are there any other issues which businesses or individuals who may be affected would like to raise?

The role of the Taylor review should also be considered. This consultation has not allowed the government's own review of status to occur beforehand. Should the government wish to completely depart the status of employee, (worker) and self-employed for tax purposes then the same language should no longer be used. The use of similar language adds to the confusion of small business owners.