

## **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 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 drivers at just the time they are needed most.

Government should be reconsidering plans to expand reforms of IR35 to the private sector. Any reforms should be given further 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 than public sector bodies.

### **The UK's flexible labour market**

The UK has one of the most flexible labour markets in the world. This strength has enabled our employment miracle through and since the financial crisis. It will again underpin any success the UK economy experiences during Brexit.

### **Importance of contractors**

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

This is truer for small businesses as they will need some expertise on an ad hoc basis. Recruiting experts permanently is prohibitively expensive for most small businesses: access to contractors ensures they can access skills as and when they need them.

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 provide<sup>1</sup>.

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

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<sup>1</sup> 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>

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 ad-hoc basis.

The priority must be to ensure that businesses are still able to easily access the expertise of contractors. As small businesses likely struggle the most with this it is right that they are excluded from the change in requirements.

### **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 professionals that are necessary to accurately implement complex legislation such as IR35.

The perceived success of IR35 reforms in the public sector, to the extent that they can be seen as a success, are at least in part because well-resourced government departments are able to manage the adjustments. 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 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 and prepare for Brexit will 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. As the EU labour market becomes less available to businesses during the Brexit process, 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 to IR35 rules**. This will give more time for the CEST tool to be refined and hopefully make compliance for businesses easier.

### **Issues with the CEST tool**

The CEST tool is unreliable, and having to use it on a more frequent basis will add to the administrative burdens faced by small firms. There have been reports that the tool does not align with court judgements and, in around 15% 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.

Overall, FSB's concern is that rushing to take public sector IR35 legislation changes into 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 an understanding of the rules.

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, opportunity and 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, Senior Policy Advisor, on 020 7592 8126 or [Lorence.nye@fsb.org.uk](mailto:Lorence.nye@fsb.org.uk).

Yours sincerely,



**Tony Baron**

Chairman of the Finance, Tax & Economy Committee  
Federation of Small Businesses

*Question 1 – Do you agree with taking a simplified approach for bringing non-corporate entities in to scope of the reform? If so, which of the two simplified options would be preferable? If not, are there alternative tests for non-corporates that the government should consider? Could either of the two simplified approaches bring in to scope entities which should otherwise be excluded from the reform? Is it likely to apply consistently to the full range of entities and structures operating in the private sector?*

*Please explain your answer.*

The primary measure for business capability to adjust to the changes is the number of employees they have. FSB believes business size by employees should be the main tests, while one of the other two tests should be employed to confirm a business' status as "small."

This means if a business has turnover of greater than £10.2m, and a balance sheet of greater than £5.1m, but fewer than 50 employees they should be considered a small business for the purpose of the implementation of off-payroll rules.

*Question 2 – Would a requirement for clients to provide a status determination directly to off-payroll workers they engage, as well as the party they contract with, give offpayroll workers sufficient certainty over their tax position and their obligations under the off-payroll reform?*

*Please explain your answer.*

FSB believes it is entirely necessary that the end clients provide all parties with a status determination. Off-payroll workers themselves should be the highest priority. HMRC should provide best practice guidance for how companies should share status information with contractors.

*Question 3 – Would a requirement on parties in the labour supply chain to pass on the client's determination (and reasons where provided) until it reaches the fee-payer give the fee-payer sufficient certainty over its tax position and its obligations under the offpayroll reform?*

*Please explain your answer.*

There should be some mechanism for ensuring parties pass the correct information to the fee-payer. But further consultation with employment agencies may be required to establish the most effective structure for these mechanisms.

FSB also believes a mechanism for a proactive enquiry by a fee-payer should be established. If a fee-payer is facilitating a new engagement they should be able to make contact with the end client to find out the result of a determination in a streamlined way. Guidance for end clients on how to make this readily available should be led by HMRC.

*Question 4 - What circumstances may result in a breakdown in the information being cascaded to the fee-payer? What circumstances might result in a party in the contractual chain making a payment for the off-payroll worker's services but prevent them from passing on a status determination?*

There are several circumstances where a breakdown in communication could occur. Unexpected absences of employees is the most likely reason, but there could be other continuity issues that result in a breakdown in communications. The communication infrastructure of some businesses may not yet be prepared for the requirements, leading to missed correspondence. This is yet another reason FSB believes HMRC should further delay implementation.

*Question 5 – What circumstances would benefit from a simplified information flow? Are there commercial reasons why a labour supply chain would have more than two entities between the worker's PSC and the client? Does the contact between the feepayer and the client present any issues for those or other parties in the labour supply chain? Please explain your answer.*

It is fairly frequent for more than two entities to exist between the PSC and client. It is also quite regular for the end client to not know exactly what the PSC is being paid as they may just be paying a fee to one of these entities.

If IR35 does apply to a relationship, it may be far simpler to require the end client to pay the PSC via their current payroll system.

Another approach may be to assign the responsibility to the first agency in the supply chain for an engagement that is deemed inside IR35. It should follow that a direct relationship between them and the PSC will be established for the purposes of payment of remuneration.. This will mean fewer difficulties with other parties in the supply chain but will perhaps not burden the end-client in a way that they will not be underprepared or ill-informed to handle.

This solution does indeed also present issues for others with contracts further down the supply-chain but is perhaps the best means of ensuring minimal confusion and the easiest means of compliance.

*Question 6 – How might the client be able to easily identify the fee-payer? Would that approach impose a significant burden on the client? If so, how might this burden be mitigated? Please explain your answer.*

In labour supply chains where there is a single agency or intermediary between the PSC and the end client the fee-payer will be easily identifiable. But where there are two or more entities between PSC and end client the burden increases exponentially.

It may also not be clear to the end client how their labour supply chain is structured: they may simply rely on the agency they have a relationship with.

It may, for these reasons, again be more effective to pay the PSC directly through the normal payroll structures of end clients.

*Question 7 - Are there any potential unintended consequences or impacts of placing a requirement for the worker's PSC to consider whether Chapter 8, Part 2 ITEPA 2003 should be applied to an engagement where they have not received a determination from a public sector or medium/large-sized client organisation taking such an approach? Please explain your answer.*

FSB welcomes that this proposal relieves the burden on small businesses that are ill-equipped to adjust to the administrative costs of IR35 and would have been less likely to engage contractors to provide essential skills.

This does, however require the individual operating through a PSC to be aware of the firm they are contracting with.

HMRC should provide guidance to PSC's and end clients alike to ensure the appropriate compliance steps are taken. One key element of this would be a requirement for small businesses to share their exempt status with a PSC, thereby prompting the PSC to take the correct steps to ensure compliance.

*Question 8 – On average, how many parties are in a typical labour supply chain that you use or are a part of? What role do each of the parties in the chain fulfil? In which sectors do you typically operate? Are there specific types of roles or industries that you would typically require off-payroll workers for? If so, what are they?*

PSC's operate in a variety of supply-chain structures and industries. This makes it particularly difficult to generalise about a typical format. However, HMRC should consider

industries that rely on the rapid allocation and deployment of highly-skilled workers, particularly in innovative fields. PSCs are most likely to be in demand for these roles as they provide the combination of expertise and responsiveness that businesses rely upon when innovating or responding to change quickly.

Creating a burdensome process for accessing these skills blunts one of the key gains that businesses enjoy when engaging PSCs. The knock-on effect on the economy would be great. That is why HMRC should delay implementation, allowing time to ensure there is a good understanding of IR35 among clients.

*Question 9 – The intention of this approach is to encourage agencies at the top of the supply chain to assure the compliance of other parties, further down the chain, through which they provide labour to clients. Does this approach achieve that result?*

Although it creates a strong incentive for agencies at the top of the supply chain to behave correctly, it may require too much over-sight and policing from them to be effective.

FSB believes that – cases where the end-client finds their engagement to be inside IR35 – either they or the first agency in the supply-chain should then take responsibility for paying the PSC and the right tax over to HMRC.

This takes some of the steps that the information has to be passed down out and makes compliance easier.

It does raise the question of how other agencies in supply chains will be paid, but it means an easier path to compliance for the end client and less risk for the agency at the top of the supply chain.

*Question 10 – Are there any potential unintended consequences or impacts of collecting the tax and NICs liability from the first agency in the chain in this way taking such an approach? Please explain your answer.*

If this approach is taken the first agency in the chain should also establish a direct payment relationship with the worker inside IR35. A clear potential unintended consequence of not having this responsibility throughout an IR35 engagement is that communications fail to reach the fee-payer and compliance becomes more difficult.

*Question 11 - Would liability for any unpaid income tax and NICs due falling to the client (if it could not be recovered from the first agency in the chain), encourage clients to take steps to assure the compliance of other parties in the labour supply chain?*

As it is the end client that has the best knowledge of the working relationship, and is responsible for determining status, or using the CEST tool to do so, it is FSB's preferred approach that the end client has ultimate responsibility for tax and NICs deductions. In addition, however, it is preferable for this to take place by direct payment to the worker via their PSC rather than being passed along the supply chain. This is to ensure the most straightforward route to compliance is established.

*Question 12 – Are there any potential unintended consequences or impacts of taking such an approach? Please explain your answer.*

The end client having the responsibility for determining status, and the additional burden of direct payment, within an IR35 engagement may cause a fall in demand for flexible labour as it increases the overall cost of engaging a PSC.

*Question 13 – Would a requirement for clients to provide the reasons for their status determination directly to the off-payroll worker and/or the fee-payer on request where those reasons do not form part of their determination impose a significant burden on the client? If so, how might this burden be mitigated? Please explain your answer.*

FSB believes it should be a requirement for end clients to provide reasons for a status determination to the off-payroll worker and/or fee-payer directly when requested.

It is important that HMRC ensures the CEST tool inputs and results are clear, easily stored and shareable. If the client has relied upon the CEST tool then simply transferring this data should suffice.

It may be more burdensome if the CEST tool has not been used to make a determination or has come up with a non-determination. This would mean the client has decided the status of the engagement themselves. In this instance reasons should be given in writing and add a layer of administrative burden to the process.

*Question 14 – Is it desirable for a client-led process for resolving status disagreements to be put in place to allow off-payroll workers and fee-payers to challenge status determinations? Please explain your answer.*

FSB believes a client-led process may in fact disadvantage genuinely self-employed workers who could otherwise be engaged by risk averse clients. If this is the case a client-led process may not satisfactorily challenge a potentially incorrect determination. Given the size and power imbalance between a one-man-band and a medium-sized or large company, the likely outcome will be that the contractor has to either accept an incorrect determination or decline the contract, thereby impacting their own business revenue.

For this reason an independent adjudicator should be set up to address such disputes.

*Question 15 – Would setting up and administering such a process impose significant burdens on clients? Please explain and evidence your answer.*

FSB believes this will vary between firms depending on the how well their current internal HR processes are developed. This will mean a different experience and level of quality from each firm.

This is another reason that it is preferable for disagreements to be dealt with by an independent impartial body.

*Question 16 – Does the requirement on the client to provide the off-payroll worker with the determination, giving the off-payroll worker and fee-payer the right to request the reasons for that determination and to review that determination in light of any representations made by the off-payroll worker or the fee-payer, go far enough to incentivise clients to take reasonable care when making a status determination?*

FSB does not believe these steps are enough of an incentive for all end clients to take reasonable care when making their determination. The end clients that are most comfortable with IR35 rules will most likely take reasonable care to examine their contractor relationships on a case by case basis as the cost per case assessment is relatively low.

For end clients that have staff who do not have knowledge of this complex legislation blanket, risk averse and/or ill-informed decisions are more likely. This is because it is more time-consuming and costly for each contractor's working relationship with the end client to be judged with care by people who are unfamiliar with IR35.

It may, for businesses that are unfamiliar with IR35, be more efficient overall to rule all their contractors inside IR35 and avoid the risk of having a large unexpected NICs bill in the future.

As contractors are currently responsible for their status determinations, it is more likely that the average private sector firm is ill-informed about IR35 than well-informed.

For this reason, the presence of an independent adjudicator may provide a good incentive for the end client to get determinations right in the first instance and offer assurance of a fair hearing to contractors who are concerned about blanket decisions.

*Question 17 – How likely is an off-payroll worker to make pension contributions through their fee-payer in this way? How likely is a fee-payer to offer an option to make pension contributions in this way? What administrative burdens might feepayers face which would reduce the likelihood of them making contributions to the offpayroll worker's pension?*

Contractors see themselves as self-employed and this is unlikely to change if one of their engagements is deemed to be inside IR35. For contractors that are frequently engaged by multiple clients for short periods, it may actually add to complication and confusion regarding how much they are saving. For this reason, it is better that the control of lifetime and retirement savings remains entirely with the contractor.

Government should instead be looking at other incentives, such as reliefs for contractor pensions, which would help to address the long-standing issue of low rates of pension savings among the self-employed.

*Question 18 - Are there any other issues that you believe the government needs to consider when implementing the reform? Please provide details.*

It is likely that the CEST tool will be heavily relied upon by most private sector firms that have little knowledge of IR35.

It is vital that the tool is further refined to reduce the number of undetermined cases going through the system.

The tool needs to ensure all questions are answered so that determinations stem from a holistic view of the working relationship. The tool should try to match case law closely and consider factors that are pivotal in the courts, such as Mutuality of Obligation with high level of importance, whilst still not being dominated by a single factor.

Clear explanation of the results will also help end clients to explain their determination to workers and fee-payers. This clarity in explanation will reduce the number of appeals and make the grounds for appeal more precise.