Response from ICAS to the HMRC discussion document

Intermediaries Legislation (IR35)

29 September 2015
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About ICAS

1. The Institute of Chartered Accountants of Scotland ("ICAS") is the oldest professional body of accountants. We represent around 20,000 members who advise and lead businesses. Around half our members are based in Scotland, the other half work in the rest of the UK and in almost 100 countries around the world. Nearly two thirds of our members work in business, whilst a third work in accountancy practices. ICAS members play leading roles in around 80% of FTSE 100 companies. ICAS is also a public interest body.

General Comments

2. ICAS welcomes the opportunity to comment on the discussion document issued by HMRC on 17 July 2015 on Intermediaries Legislation (IR35).

3. The single most important recommendation for both simplifying the tax system and improving compliance with the existing IR35 rules is to merge income tax with National Insurance contributions paid by the employed and the self-employed. The differential in the rates between the employed and the self-employed, and the impact of the employers contribution is a key factor in individuals using personal service company structures. We look forward to contributing to the Office of Tax Simplification study on this matter in the forthcoming months.

4. The difference in the rate of corporation tax and the rates of income tax are also a factor in making the personal service company attractive. The differential is substantial for higher rate taxpayers and when combined with the ability to receive remuneration as dividends rather than salary it can make the financial decision to use a personal service company very straightforward for taxpayers. The illustrations in the discussion document demonstrate the impact on the cash received in different scenarios.

5. ICAS supports the recommendation of the Office of Tax Simplification to suspend the IR35 legislation for a limited time, with a longer term view to abolishing the IR35 legislation and replacing it with a clearer test on the existence of employment.

Specific discussion points

1. The Government would welcome any evidence on the use of other types of intermediaries to which IR35 may apply

ICAS does not have evidence on other types of intermediaries.

2. The Government would welcome further evidence from stakeholders on how Personal Service Companies currently operate IR35 and the issues that the rules create

Anecdotal evidence suggests that many large businesses, such as financial institutions, use personal service companies and insist on this approach to manage their cost base. Contracting with personal service companies and self-employed individuals has become part of established working patterns and smaller businesses may insist on using a personal service company when they realise the financial consequences.

The issues for individuals who use personal service companies are complex and the benefits of providing greater independence are balanced against the drawbacks of the absence of employment rights such as sickness pay, protection from unfair dismissal, maternity leave, redundancy, holiday pay, national minimum wage and auto-enrolment. These drawbacks may be considered acceptable by those who fully analyse whether they should operate a personal service company but there are probably a considerable number of individuals using personal service companies, or who are obliged to work in this way, who do not appreciate the wider legal consequences.
Engagers/employers are aware of the risks of mis-classifying individuals and are conscious of the need for care in this area. HMRC has been successful in challenging small and medium-sized businesses on this issue and these businesses tend not to have the resources or management time to challenge HMRC. This is in contrast to the attitude to large businesses where HMRC appear to take limited action against the use of personal service companies. This gives the appearance that HMRC condone the use of personal service companies and this has received press attention and adverse comments.

HMRC has provided the Employment Status Indicator (ESI) which is intended to assist employers identify whether an individual is an employee or self-employed. Anecdotal evidence suggests that the ESI is not used by either HMRC or employers as intended and it should either be updated and implemented as the first check on the position or withdrawn. At the moment, it is not helping engager/employers to arrive at the correct analysis of their position.

3. The Government would welcome proposals for how to improve the effectiveness of IR35 that meet the objectives of protecting the Exchequer and levelling the playing field between those who are employed directly and those who would be employed directly if they were not operating through their own company

As indicated above, ICAS believes that there will be little progress towards a level playing field without merging income tax with National Insurance contributions paid by employers and the self-employed. The NIC paid by employers on salaries paid to employees has been the key factor in making personal services companies attractive to both contracting parties. If both sides have a financial advantage in categorising their relationship as one for services rather than of service it is inevitable that they will try to structure commercial relationships to give effect to this.

4. The Government would welcome views on alternative options for more fundamental reform which meet the objectives

As noted above, ICAS supports the recommendation of the Office of Tax Simplification to suspend the IR35 legislation for a limited time to allow time to consider alternative options that give engagers/employers and taxpayers certainty on the tax position of their contractual arrangements and provide HMRC with rules that can be effectively enforced.

The types of approach that could be considered are:

- A time-based categorisation of contracts – contracts extending beyond 6 months would be treated as employment with contracts of less than 6 months treated as self-employment where certain tests were met on whether the contract fulfilled the badges of trade. There would need to be anti-avoidance provisions to prevent the use of a series of short term contracts.
- A certification system for contractors so that they provide businesses with a certificate to demonstrate that they are eligible to be paid gross for their services. Any contractors who do not have a certificate would be treated as employees and paid net of tax and NIC. This would be similar to the Construction Industry Scheme and we note that this would involve significant change in HMRC resourcing in this area.

5. The Government would welcome views on its proposal for engagers to take on more of a role in ensuring that the right amount of employment taxes are paid, including how it could be made straightforward as possible for engagers to determine whether IR35 should apply as part of their routine hiring conversations

A certification system as outlined above would involve engagers/employers in ensuring the right amount of employment taxes is paid. HMRC will be aware that adopting this approach will increase compliance costs for engagers/employers. HMRC will also require resources to issue certificates and monitor compliance.

The current position for engagers/employers is that the complexity of IR35 adds uncertainty to their processes. Engagers/employers would prefer a more simple and
certain system to determine employment status and fair and effective administration of that system.

6. **The Government would welcome views on the implications of a change in the test for whether IR35 applies, both positive and negative, and what stakeholders preferred approach would be.**

As noted above, ICAS would like to see a fundamental review of the position to address the structural issues which drive the use of personal service companies. There is merit in considering a time-based categorisation of contracts to achieve some simplification. The proposal to align the IR35 test with the test used for temporary workers in the agency rules does not appear to be a simplification.