Response from ICAS to the House of Lords Select Committee on Personal Service Companies

Call for written evidence on the Inquiry into the use of personal service companies and the consequences for tax collection

7 January 2014
About ICAS

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 introductory comments

ICAS welcomes the opportunity to provide evidence to the House of Lords inquiry into the use of personal service companies and the consequences for tax collection, the call for which was issued on 20 November 2013.

Our members experience suggests that short term contracts result in a large part from employers not being keen on taking on individuals as employees, and that many agencies are employed by large business to find these workers. Some individuals decide to operate using a company through choice rather than take on a role as an employee because they have previously experienced redundancy. The ‘one man band’ consultant may feel that he or she has more control over their own destiny. The tax structure and benefits that can be derived from a company may or may not be appreciated by the individuals until the tax adviser tells them.

The key concerns around personal service companies are therefore to do with larger businesses avoiding employment rights, for example, termination or unfair dismissal; redundancy; maternity leave; holiday pay; auto-enrolment for pension rights; or Working Time regulations. Arguably, personal service companies are a sign of the times in this complex employment regulated world and, if necessary, these concerns should be dealt with via employment legislation rather than tax anti-avoidance legislation.

In relation to the IR 35 legislation, where the status of the worker probably is one of employment, we consider that the issue is not a question of the effectiveness of the IR35 legislation, but whether it is adequately policed by HMRC.

Specific questions

1. To what extent are Personal Service Companies being used for the provision of personal services to UK businesses?

Personal service companies fall into two groups: firstly those that allow an individual to operate on a freelance basis and to build up a portfolio of clients. Secondly, there are the others where the personal service company is used to front what would otherwise be an employment but the reasons for that may not be purely tax driven, or employee driven.

Anecdotally, personal service companies continue to be used more than might be expected when the underlying status of the service provided could be considered to be that of employment. It remains the case that some individuals choose to use a personal service company whilst for others the contracting ‘employers’, particularly some large businesses, insist that services are provided to them via a personal service company rather than directly by the employee. This is due to the desire to minimise exposure to employee rights and to maintain flexibility when using specific services, and a personal service company may be insisted upon in order to remove the risk to the business of any incorrect status decision.

2. What is your view of the effectiveness and efficiency of the intermediaries legislation, first introduced in 2000, in facilitating tax collection?

It is difficult to judge the effectiveness and efficiency of this because IR35 and the intermediaries legislation is an anti-avoidance measure. Any deterrent effect would, by
definition, not be capable of being quantified. The fact that IR 35 remains an on-going topic and debate suggests that there remain problems in relation to it. Our members continue to report concerns for those with personal service companies and their lack of certainty regarding the tax position and also their lack of employment protections for those pushed into personal service companies. Our members also report that once clients have started to use personal service companies they are well aware of the work that HMRC have been doing on IR35 and do give a lot of thought to their employment status.

3. **Should the current intermediaries legislation be reformed and if so, what would be the alternatives?**

We support the recommendation of the Office of Tax Simplification to suspend the IR 35 legislation for a limited period, with a longer term view to abolishing the IR35 legislation.

Small businesses that choose to operate through a company should be allowed to seek customers wherever possible. These clients understand that they have no employment rights and accept that they need to build their customer base and expertise for the future. In many cases they are happy to have the flexibility to work on a short term basis.

4. **To what extent does the current IR35 legislation impose additional compliance burdens and administrative costs?**

The most costly aspect of IR 35 companies is the lack of certainty in the tax affairs of those who may potentially be within the legislation.

5. **Are the current avenues of consultation on IR35 working and what more should be done to ensure that the Government listens to interested stakeholders?**

The current avenues are helpful and should continue to be used.

The problem of disguised remuneration would be better addressed at a more fundamental level. In part it is due to the tax and NIC costs of employment relative to other ways of providing the services of a person, ie through a company; in part it should be addressed via employment legislation.

6. **Are HMRC’s recent efforts in improving the administration of IR35 judgement cases working? Is more guidance and advice needed to aid individuals in judging the status of business transactions for themselves or should further resources be given to HMRC for compliance efforts?**

We welcome the guidance from HMRC that aims to improve IR35 but whilst it is helpful we consider that the question should be whether IR35 legislation and those who are caught within its provisions are adequately policed by HMRC.

7. **Do businesses insist on the use of Personal Service Companies? If so, should responsibility be placed on them rather than the worker to decide whether a business transaction falls within IR35?**

Anecdotally we understand many large businesses, particularly financial institutions using short term contracts, insist on this. Smaller businesses, may insist on a personal service company when they realise the consequences (for example, following a PAYE compliance review). In relation to the latter question, responsibility ought to sit with the business contracting with the personal service company because it is usually responsible for requiring the use of the personal service company.
8. Are individuals forced into the use of a Personal Service Company as a prerequisite for being considered for work? If so, what can be done to ensure that the use of a Personal Service Company is appropriate for the individual?

As above, we consider the answer to this is ‘yes’ but have no evidence of the scale or extent. The main reasons appear to be partly the cost of employer NIC, and partly the employment law burdens, which are not taken on with contractors. Focus on employer requirements may be more effective than seeking individual protection.

9. To what extent are Personal Service Companies still used in the Public Sector? Should those engaged in public bodies and similar organisations be prevented from working through a Personal Service Company? If so, would the Public Sector experience difficulties in obtaining the skills and expertise that are needed?

We have no clear, current evidence regarding this, although anecdotal evidence suggests it is more limited and only for short term contracts.

10. What role do Umbrella companies play? To what extent are agencies encouraging individuals to enter into such structures?

The umbrella company enables a worker to provide their services through a company but without the need to set up their own individual personal service company.

Some of our members report that there is widespread referral of low paid workers to umbrella companies by agencies. The agency receives a fee from the umbrella company for sending them the business and the agency avoids the cost of running a payroll. If the umbrella company issues an overarching contract of employment the worker is reportedly able to claim travel and subsistence costs that they would not usually be able to as an employee of an agency. The umbrella company reportedly takes a cut from this ‘tax saving’.

11. Aside from the issues of Tax and National Insurance, what are the wider benefits and drawbacks for the individual of using a Personal Service Company?

A personal service company has the benefits of giving the individual greater independence; he/she is his/her own boss and can use the company to build a freelance, portfolio type of career with limited liability. However for some IR 35 companies the independence can be in theory rather than practice.

The drawbacks of a personal service company are around employees’ rights and protection that have been sidestepped by the main business, for example, in relation to no sickness cover; if there is a termination or unfair dismissal; redundancy; maternity leave; holiday pay; auto-enrolment for pension rights; Working Time protections; or when the worker is reaching retirement and there is no ‘company’ pension provision. The drawbacks may be considered acceptable by those who fully analyse whether they want to use an IR 35 company and its implications but there are probably a considerable proportion of IR 35 companies where the individuals do not fully appreciate the consequences. Equally, individuals may be content to use a personal service company when they are fit and young but all too frequently they do not seem to fully appreciate the drawbacks of the structure until unforeseen circumstances forces it upon them.