Reforming IR35

Engaging with the Government's proposals for off-payroll working in the private sector

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Background

IR35 is a tax law which was implemented in April 2000. The aim of the legislation was to combat tax avoidance by self-employed workers who provided their services through an intermediary (i.e. a personal service company, or PSC), but who would be classified as an employee if the intermediary was not used. These workers are labelled by HMRC as 'disguised employees' and, under the remit of IR35, they must pay income tax and National Insurance Contributions as if they were employed. HMRC and the Treasury – the two bodies with responsibility for implementing and enforcing the legislation – aimed to benefit from the revenue generated from the Government cracking down on tax avoidance within this area.

Reforms in recent years to IR35 and associated policy and legislation have taken place against a backdrop of significant structural shifts in the UK labour market. An increase in self-employment and flexible working which started after the 2008 financial crisis and continued over the last decade, fuelled by the popularity among both workers and consumers of gig economy platforms, has prompted policy-makers to consider how policy and regulation should be reformed to account for how the nature of employment is changing in the UK.

There are a range of different factors within this that are driving policy-makers' thinking. For the Treasury, arguably the primary consideration is the tax revenue forgone as employees shift to self-employment, taking advantage of lower income tax rates and national insurance contributions. For other government departments and stakeholders, there are legal issues around tax and employment status; the issue of financial security and how to address the inequality between traditional employees and others with regard to the benefits of policies such as the national living wage and workplace pensions; and how to achieve greater certainty and stability for those in 'insecure' work without impeding the growth of successful businesses who rely on different forms of flexible labour.

The Taylor Review, commissioned by the Prime Minister shortly after she took office in summer 2016, sought to address a number of these issues in a report published in July 2017. The ensuing debate over the nature of modern employment and how to balance flexibility and security for both workers and employers, and the subsequent government response to the review, has ensured that it is a topic that has remained at the forefront of the political agenda and a key part of Theresa May's domestic policy programme.

In this context, the issue of IR35 and compliance has increasingly become a priority for the Government to address, and it is naturally the first two aspects listed above – tax revenue and legal status – that have driven the Government to take action. Reforms to the legislation have taken place over several years; the Coalition Government implemented a number of measures on off-shore intermediaries and tax avoidance. Following the Conservatives' election victory in 2015, the Government undertook one of the most contentious policy changes since the legislation was introduced in 2000 by restricting tax relief on travel and subsistence expenses for workers engaged through umbrella companies.

The Government instigated these reforms due to concerns that some umbrella companies were marketing themselves as a route to avoiding tax and national insurance. Tax avoidance was possible because PSCs allow workers to register their normal home to work travel expenses as tax deductible by artificially becoming agency workers. The legislative changes demonstrate the extent to which IR35 reforms are driven by considerations around maximising tax revenues. Alongside these measures, HMRC also published a discussion document on the future of IR35 which eventually led to the Government proposing reforms to the legislation in 2016.

Reform in the Public Sector

Following confirmation at the 2016 Spring Budget, the reforms to the use of PSCs in the public sector came into effect from April 2017, just over a year after the consultation was first announced. The substance of the reforms means that where responsibility for determining IR35 status once rested with the worker, it has transferred to the end-client. If IR35 applies, the body engaging the contractor now accounts for and pays the relevant tax and national insurance liabilities; if the worker is engaged via an agency, it is the agency that is liable.

When first published in the consultation in 2016, the proposals encountered significant opposition from stakeholders, with respondents to the consultation warning that there would be a significant negative impact on the ability of public sector organisations to complete projects with a reduced labour supply, as well as increasing overall labour cost. Despite such opposition, Ministers pushed ahead with the reforms.

As with the initial consultation, the stakeholder reaction to the rollout of the reforms in the public sector during their first year has been negative. Despite the Treasury's positive view of how the changes have worked regarding increasing compliance, there is an implicit acknowledgement in the timing of the consultation on extending reforms to the private sector that there have been a number of issues raised with the Government over the implementation and effectiveness of the reforms.

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The text of the consultation on reforms in the private sector contains details of an analysis undertaken by HMRC lauding the increase in compliance as a consequence of the changes but acknowledges that a number of issues were raised by stakeholders both during and after the implementation. Much of the feedback on the changes from organisations representing contractors and self-employed workers in the public sector argues that the reforms have not only led to a significant resource burden on public sector employers, but also that HMRC has been unable to respond effectively to the changes. Its CEST (Check Employment Status for Tax) tool, intended to simplify the process of determining IR35 status, has been widely criticised as ineffective; it has been suggested that rather than use the CEST tool, employers have either been making blanket decisions on IR35 status for all contractors, or choosing not to engage contractors using PSCs.

Reform in the Private Sector

The Government announced its intention to extend the public sector reforms to the private sector at the 2017 Autumn Budget. There had been a widespread understanding that this had been the Government's intention since the public sector reforms were first floated, and there had not been any change in the Government's plan to do so despite the negative response to the changes.

The Government had stated in response to a parliamentary question in October 2017 that the cost of non-compliance in the private sector was continuing to increase, estimating a cost to the Exchequer of £1.2bn a year by 2022/23. However, despite these figures communicated in written answers and mentioned in the Autumn Budget, Philip Hammond, Chancellor of the Exchequer, omitted any mention of Government plans to consult on the extension of the IR35 reforms to the private sector in his Spring Statement in March 2018. This came as a surprise to those who were expecting formal confirmation of a consultation, something which had been widely briefed to the media in advance of the statement.

It was understood that the Treasury had deliberately adopted a cautious approach to proceeding with reforming IR35 in the private sector in light of the criticism experienced during the rollout of the public sector reforms, with officials indicating that there had been work underway to fully assess the impact of the rollout before formally seeking views from stakeholders over how to move forward.

The consultation is not merely focused on technical details of how the reforms can be extended with the Treasury having already made a decision to move forward, but whether this is indeed the best way for the Government to proceed. Therefore, there remains plenty of scope for stakeholders to shape the development of this policy.

The consultation document was published on 18th May 2018. It outlines proposals for extending the public sector reforms to the private sector, asking a series of questions on how it could be adapted to better suit businesses, the administrative impact, and how the Government could make implementation simpler and easier to process for both employers and workers. Alongside this, it also presents different options for reform to increase compliance; such as requiring businesses to make sure that their supply chain is compliant with off-payroll working regulation or introducing new requirements for businesses to keep records of contracts, shift rotas, and line management reporting requirements in relation to engagements with contractors.

While the tenor of the document suggests that the Government is relatively relaxed about the impact the reforms have had in the public sector to date, simply extending the reforms as they exist in the public sector to the private sector is not the only option that policy-makers are considering. The consultation is not merely focused on technical details of how the reforms can be extended with the Treasury having already made a decision to move forward, but whether this is indeed the best way for the Government to proceed. Therefore, there remains plenty of scope for stakeholders to shape the development of this policy through the consultation process; although there is naturally a greater focus in the document on the option of extending the existing reforms, the Treasury is clearly determined to avoid some of the criticism it has received over the last 12 months in response to the public sector reforms.

Next Steps

The consultation is due to close on 10th August. The Government has not committed to a formal timetable for introducing the reforms once the consultation has closed, although its response to the consultation should be expected to be published in the autumn.In theory, it will be possible for implementation to take place in April 2019 should the changes be confirmed in the 2018 Autumn Budget in November, and subsequently included in the Finance Bill - the piece of legislation that includes all of the spending and tax measures from a Budget - normally passed by Parliament within 3-4 months of the Chancellor's statement.

However, given the cautious approach to date and the apparent determination in the Treasury to ensure that the process reflects stakeholder concerns following the disquiet around the public sector reforms, it is more likely that an implementation date of April 2020 will be pursued. In light of the delayed consultation process, the priority attached by the Government to mitigating criticism of the policy, and the range of options put forward in the consultation, a rushed attempt to enact the changes would appear inconsistent with the Government's aims and risk losing any support for the policy from stakeholders.

Therefore, proactive engagement with policy-makers is essential for businesses with an interest in the outcome of the consultation, and the consultation process and likely timing of the reforms leaves plenty of scope for the development of policy to be influenced. With the Treasury consciously reaching out to businesses to ensure their voices are heard – both as part of the formal consultation process and as it considers other feedback on the proposals – it is vital that those affected by potential policy change take the opportunity to engage meaningfully and constructively to shape the outcome of the process.

How GK Can Help

GK has provided political due diligence, government affairs support, and policy research and analysis to a number of businesses, investors and trade associations with an interest in IR35 legislation and regulation of contractor labour. This has included proactive engagement with senior stakeholders in Government and Parliament on the reforms to rules in the public sector, and earlier research and analysis of the changes to travel and subsistence tax relief for umbrella companies.

GK also has considerable experience helping stakeholders to develop responses to government consultations, devise strategies to engage with decision-makers at all levels in order to shape the development of policy and regulation and create media and communications campaigns to influence the trajectory of policy-making.

To learn more about how GK can help your organisation respond to the consultation by the closing date of 10th August, or with wider support on these issues, please contact:

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