



HM Revenue
& Customs

Research report

Intermediaries Legislation Qualitative Research

To understand the implications for employers/engagers, if they were given responsibility for operating the Intermediaries Legislation

Lucy Joyce, Graham Keilloh, Cheryl Salmon

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Intermediaries Legislation Qualitative Research***About Personal Tax Customer, Product & Process (PTCPP)***

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Research requirement (background to the project)

The Intermediaries Legislation is designed to prevent individuals who would normally be taxed as an employee, but are supplying their services through an intermediary – usually their own limited company known as a Personal Service Company (PSC) – from avoiding the tax and National Insurance (NI) that would otherwise be due on the employment income.

Presently the liability and hence responsibility for deciding whether the rules should apply lies with the PSC (intermediary). It is thought though that the legislation could be more effective in protecting the Exchequer and level the playing field more between direct employees and those who work in a similar manner to direct employees but through their own limited companies. The government believes that the current legislation is not working as effectively as it should be and non-compliance with the legislation is widespread.

On 17 July 2015, HMRC published a discussion document opening up dialogue with stakeholders on how to reform the rules. One option discussed in the document is to make employers/engagers responsible for determining whether the rules apply, rather than the PSC.

There was little robust evidence on how employers engage workers via PSCs, how they go about doing so, and how this affects employers. HMRC therefore commissioned this research to understand likely implications for employers/engagers if the rules were to change in the future.

The research aimed to explore:

- **Awareness and understanding:** To understand the extent to which employers are aware of and understand the Intermediaries Legislation and assurance processes;
- **Insights:** To provide in-depth understanding of employers behaviours, processes and burdens when hiring workers through companies in contrast to direct engagement;
- **Impact of shifting responsibility:** To assess the likely impacts on employers if the responsibility for operating the rules is placed on them; and
- **Barriers and Incentives:** To explore likely incentives for non-compliance and barriers to compliance.

When the research took place

The research was designed and carried out between September and November 2015. Fieldwork was undertaken between 6th and 19th October 2015.

Who did the work (research agency)

The research was undertaken by the Employment Welfare and Skills (EWS) team working in Ipsos MORI's Social Research Institute.

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Method, Data and Tools used, Sample

A qualitative approach was undertaken to this study. A total of 36 depth interviews were undertaken (34 by telephone and two face to face). Two of these interviews engaged multiple participants resulting in a total sample of 41 participants.

The organisations who took part include Government Departments, Public Sector organisations, Large Businesses, Small and Medium Enterprises (SMEs), Care and Support businesses and Recruitment Agencies. A breakdown of the interviews by sector is shown in the table below.

Table 1 Profile of Participants by Sector

Sample	Achieved interviews	Total participants
Government Departments	4	6
Public Sector	7	10
Large Business	8	8
SME	7	7
Care and Support	6	6
Recruitment Agencies	4	4
Total	36	41

Main Findings

The main research findings are outlined below.

Processes

First we explored the use of temporary staff and current processes in place for managing this. A number of issues were noted:

1. Flexibility is the key benefit of using temporary staff

Organisations noted a range of reasons for using temporary staff, though in most cases these related to increased **flexibility**. The specific reasons mentioned included:

- Saving money;

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- Reduced financial commitment and therefore lower risk to business;
- Staff required for a particular project or task;
- Managing seasonal fluctuations (e.g. more business prior to Christmas); and
- Covering sickness or maternity leave.

“It’s because [employers] want the flexibility. As an employer you don’t always want to take someone on as a member of staff” (Recruitment Agency)

2. Extent that temporary staff were used varied

The use of temporary staff varied among businesses in terms of:

- **Frequency:** In some instances temporary staff were used rarely and for specific needs only, other organisations used them as a matter of course;
- **Roles:** There was a full range of tasks/seniority noted, from cleaners through to senior consultants;
- **Where they get their staff from:** Staff were sourced through a number of channels, including recruitment agencies, approved supplier lists/frameworks or simply returning to staff the organisation had used before; and
- **Numbers:** Some almost never use them, perhaps due to small size or lack of need (they only use them ‘as and when required’). Most used temporary staff for ad hoc roles like plumbing and window cleaning as a minimum. Though the number of temporary staff used and what for varied, both by organisation and within organisations, depending on need. One construction firm estimated half of their staff were self-employed.

The use of temporary staff was viewed as being **especially beneficial in some sectors**, including construction, IT, consultancy and design. It was suggested that the nature of these organisations meant there was lots of ‘project-type’ work where staff were needed for finite periods. It was also thought to be ‘in the nature’ of some other sectors, such as care and social work, to have lots of temporary staff. In contrast, some organisations suggested they rarely used temporary staff (mainly due to a lack of need) and this was identified particularly in the case of the **SMEs** in our sample who often said they lacked a need for temporary staff and preferred to maintain control and put staff on the payroll to avoid non-compliance.

3. Processes in place for managing temporary staff

The processes in place for managing temporary staff **varied** across organisations. All organisations had processes in place but they varied in how extensive, rigid or joined up they were in terms of checking tax status or the nature of the contract. Participants from **Government Departments and the Public Sector** talked of **strict guidelines, checking and processes** for temporary staff - although the diversity and size of the public sector organisations (many of which were very large) meant this was not always implemented

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consistently. Those from Government Departments also often mentioned strict rules on pay and contract duration for their temporary staff.

A few organisations mentioned having **approved suppliers' lists and frameworks** which were managed by procurement departments, HR or similar (though some said it was finance or a front line head of department with ultimate responsibility) which required various checking of and information from the subcontractors – such as history, proof of status and the like. A small number of Large Businesses had very formal processes but were not entirely 'joined up' – for example a representative of HR or compliance might be familiar with the process but one from finance not so. Smaller organisations, particularly in the private sector, indicated that their processes were generally less formal, and the decisions to use temporary staff were often taken at a 'front line' managerial level based on need (albeit sometimes with more senior formal 'sign off').

“It mitigates the risk if engaging with limited companies, you are engaging with the company rather than the person” (Local Authority)

“We don't want to pay them and later find out we should have been paying them PAYE” (Large Business)

A few organisations in the public and private sector expressed a preference for dealing with temporary staff that were **limited companies** (rather than self-employed) as they perceived this to be less risky **in terms of compliance**. One Public Sector organisation indeed said that '99 times out of 100' non-limited companies among their temporary staff were put onto their payroll. Some preferred to work with **agencies** for similar reasons for feeling more comfortable about compliance, on the assumption the agency would 'sort out the tax'.

There were a few examples of organisations requiring their subcontractors to **sign an undertaking** stating that they would abide by all legislation, including tax legislation, again to protect the organisation from liability.

Checking of temporary staff's **status as a PSC** or otherwise was less formal or widespread (with the exception of Government Departments). There was a common assumption particularly evident in smaller organisations that subcontractors will deal with their own tax and that this is in the 'nature' of being self-employed. Therefore many organisations, particularly smaller ones, stated that they do not ask about tax status.

“I imagine if they are self-employed they would sort out their own taxes, [I] don't ask if they do” (Care and Support)

There was evidence of employers checking the **employment status** of temporary staff using a range of employment status tests both within the public and private sector, with many mentioning an HMRC online tool. Organisations were often **mindful of the need to check**

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employment status to protect themselves from non-compliance. For example, one large business brought in a contractor to provide advice on such issues and others had put all temporary staff of their payroll in order to 'guarantee' correct compliance.

Response to the Intermediaries Legislation

The research explored awareness of the rules and responses to a shift in responsibility from the PSC to the employer.

Awareness of the rules was generally fairly high, albeit mixed, with those in Government Departments, Large Businesses or in finance roles tending to be more familiar with it though some participants across a number of sectors had not heard of it at all.

4. There is general resistance to the proposed responsibility shift

Responses to a **potential** shift in responsibility for determining if the intermediaries rules apply were consistent across organisations. Resistance tended to relate to views on how this would impact on employers and how it would affect the employee.

Impact on the employer

Overall respondents thought that the potential change would result in a loss of flexibility. There was a general cynicism regarding why this responsibility should shift and was seen as 'another burden' for organisations. Organisations felt as though HMRC was 'passing the buck' and they were unable to see an upside for them. It was also said the current economic climate meant this was not a good time to make this change for either the public or private sector.

A number of specific issues were noted:

- **Administration:** There was a perception among many organisations interviewed that this new system would require employers to bring in processes to check the tax circumstances of all temporary staff and to 'test' to see whether they should be an employee more thoroughly and consistently. Some organisations suggested that this would require new administrative systems to be introduced which would have time and cost implications. The need to monitor status on a more ongoing basis was also noted. For example, it was said that as the circumstances of temporary staff was open to change, this would need to be observed and monitored on a more ongoing basis which could have huge administrative and cost implications;

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- **Cost:** In addition to the administration costs of introducing new systems, many employers were concerned about the cost impact of potentially having more staff on their payroll as well as having to offer employee benefits (such as holiday pay). It was mentioned by a few organisations that this may have knock-on impacts of losing staff or putting prices up;
- **Caution:** There was a sense that employers prioritised lowering risk and ‘err on the side of caution’ with such things – they were looking for protection from risk. Therefore out of caution it was said employers would be likely to put more staff on payroll as a result of the change, perhaps with temporary contracts, which would have the down side of lowering their flexibility. They may also similarly seek to use fewer temporary staff and resource jobs internally resulting in less suitable staff undertaking tasks.

“It's really annoying because then I have to employ all these people then make them redundant when the work is finished. Or what if the work is done but it's not up to scratch? I don't want to use him again, but he's now an employee with employment rights” (SME)

- **Confusion:** Some details of the potential application change confused participants, for example how the system would apply to umbrella bodies – i.e. would the compliance responsibility stay with them or shift to the employer.

Impact on employees

Concerns were also raised in relation to the impact the change would have on employees and the relationship between employers and employees. The issues raised fell broadly into two areas:

- Working as a subcontractor or as a freelancer was often seen as a **choice** made by employees – a **flexible** way of working that they wanted to pursue. It was felt the new arrangements could see **PSCs being in effect pushed into the role of an employee**. Employers also questioned how this might work practically, including, for example, if the PSC was working for multiple employers; and
- It was also said to raise issues relating to **privacy**. For example, employers questioned whether temporary staff would want the employer to ask them lots of questions about their tax or employment circumstances, especially if they were working for competitor organisations too. They also questioned the level of disclosure required. Employers explained that it can be difficult to get information of this nature and even if the temporary employee was willing to provide the information its accuracy could be questionable.

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*“You may not just have employment income, and why should other people know that.”
(Recruitment agency)*

5. What can be done to help? The main desire is for information and clarity

The main request was for **information** from HMRC, as well as for **clarity** around the rules and the tests for employee status. There also was a desire for clarity in the implementation of and compliance with the new rules such as in what HMRC expects from organisations. This was common across almost all organisations, large and small. There also was a desire for simplicity and certainty, particularly in the employee test.

Some suggest HMRC information packs, online information, online training or seminars. One suggested a helpline.

*“If you had an HMRC publication that could explain the process that would be helpful”
(Large Business)*

But a strong feeling remains that this change would be difficult whatever help is offered.

Related to this there was a common view also that HMRC can be strict with organisations when errors are made, and many of them were wary of the possibility of being fined, even if those errors were inadvertent or due to the employer receiving incorrect information.

“You see an awful lot of Tribunal cases coming along where they missed out a tiny little thing and they end up with a huge financial penalty” (Large Business)

New test

HMRC also sought to gain responses to the ‘supervision, direction or control’ employee status test as part of the research:

- **Supervision:** Someone is overseeing the subcontractor or helping the person develop their skills or knowledge;
- **Direction:** Someone is providing instructions, guidance or advice to the subcontractor as to how the work must be done, often as the work is being undertaken; and
- **Control:** Someone is dictating what work the subcontractor does and how they go about doing the work, including moving the person from one job to another.

6. Participants desire a simpler test, but question if this test brings greater certainty

Overall, the participants **welcomed a new, simpler test** that would bring greater certainty. The present tests were considered to be ‘ambiguous’ and open to interpretation.

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“[Current tests are] quite woolly, some certainty would be helpful” (Large Business)

However, the new test **was not felt to provide greater certainty**. There was also an overall consensus that the new test would **encompass the vast majority of subcontractors**, particularly when considering supervision, as most people will be supervised to an extent. For example, a few participants mentioned that even with hiring a plumber or a builder to work on their house they would need to supervise them to an extent.

“If I hire someone to build something on the side of my house, which takes 18 months to complete, am I managing him through the process?” (Recruitment Agency)

It was also said **not to take account of more senior subcontractors** who would by their nature be more independent in their work (and require less supervision, direction and control).

Rather than the test of supervision, direction or control some participants suggested other measures (of which some are in existing tests):

- **Duration:** They must be working for the engager for a long period of time e.g. for more than three months. This measure was suggested as some subcontractors may work for the engager for a day, a week or a month, which would add increased administrative burden on the engager if they were to apply tests for this length of time;
- **Intensity:** They must be working on a full time basis. As with duration, if the subcontractor is working once a week this will add extra administrative burden on the engager;
- **Exclusivity:** They must be working only for one engager. If the subcontractor is working with other organisations there will be extra added burden on the engager and HMRC to work out their current tax contributions; and
- **Financial responsibility:** If they rather than the employer are currently financially responsible if something goes wrong in the contract they could be considered to not be an employee.

Conclusion

The potential changes were not supported by businesses overall. Many used temporary staff and considered them to be central to the success of their business – primarily in terms of the flexibility and skills they provided. The option of shifting the responsibility for applying the Intermediaries Legislation was seen as undermining their business and the relationship with self-employed workers. Businesses saw the changes as being potentially costly, burdensome and constraining. This concern was shared even by those who rarely used PSCs.

There were knock-on negative effects predicted by organisations too in that the individuals set up as PSCs may be impacted too. A common view among organisations was that they

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would 'err on the side of caution' in order to ensure compliance, this in turn would result in them using PSCs less or put them into the payroll more, either way undermining the PSCs' key benefit of flexibility.

Nevertheless also common among organisations was a desire to get it right in terms of compliance, and therefore information from HMRC as well as clarity are the main things organisations would like to help them adapt. Such information may also ease fears among organisations that this change may 'defeat the purpose' of temporary staff by losing their flexibility, as well as the other fears they have about the change.

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Appendix A: Case Studies**Case Study 1: Large Business****Employee responsible for tax compliance in a global wine company****Process**

Rules and tests played a part in how they engaged with subcontractors at the time – they were mindful of this. Individuals would either be put on payroll or paid as freelancers. It was usual to use limited companies – this felt safer.

Information about tax status was collected, following the advice of a professional hired to review their use of consultants and employment tax liability. Advice received was that *'if you are engaged with a limited company, then you are less likely to have [HMRC come back to review].'* They took a cautious approach to employing consultants and felt the need to protect themselves. This resulted in a policy where temporary staff were nearly always put on an employment contract and payroll. The only time where there may be an exception to this was when working with consultants who worked with other organisations, so that it could be easily demonstrated they were coming in on a consulting basis.

Awareness

The participant was aware of Intermediaries Legislation (referred to in the discussions as IR35), and was informed through newsletters and the Professional Firm's tax update.

Knowledge at the time was that it is a limited company's responsibility to apply PAYE to their own earnings. They were also aware that responsibility for ensuring this was carried out lies with the intermediary.

Responsibilities

Initial thoughts were that potential changes to Intermediaries Legislation would put an increased burden on the employer, due to the need for professional reviews of each PSC they engage with. The employer used HMRC's online tool to test employment status and found the list of questions *'reasonably helpful, but not conclusive'*. If changes were to come in, tools would need to be provided in order to give employers more certainty around assessing status, as they would now be ultimately culpable. A change would result in more work for the employer, not only at the beginning, but throughout an engagement with a PSC, as their status was fluid and could change during the course of a contract e.g. they may gain/lose customers. The employer considered the change to the rules may result in more consultants being put on permanent contracts, at a higher cost to the employer. In the event of such a change HMRC would need to test any tools designed to help employers determine employment status on as many scenarios as possible.

Intermediaries Legislation Qualitative Research**Case Study 2: Public Sector****Risk manager for a council, with overall responsibility for determining employment status of subcontractors****Process**

The hiring process was handled by managers at a local level. All subcontractors were given a contract which included a statement outlining their responsibility to abide by all legislation around tax compliance. The employer only engaged with PSCs, as it mitigated their risk. PSCs were asked to provide evidence of their status. This consisted of Companies House evidence and a letter from the contractor's accountant stating they were a limited company.

They were operating in this way for around five years, when they tested all subcontractors' status using the HMRC online tool. Based on the outcome, a decision was made to only engage with PSCs or employees on payroll, rather than self-employed contractors.

Awareness

They were aware that Intermediaries Legislation was the basic rule used by HMRC to ensure companies were paying the required amount of tax. They were not sure if Intermediaries Legislation applies to their subcontractors.

All contracts were dealt with by managers at a local level. It was their responsibility to ensure all subcontractors operating as PSCs read and understand the terms of their contract.

Responsibilities

They felt that while larger businesses were likely to comply with legislation, smaller businesses may have found it easier to avoid implementing changes, in order to save money. Alongside this was an ongoing sense that HMRC legislation was costing businesses a lot of money – the council only recently spent £150,000 implementing auto-enrolment for staff. The day-to-day impact on the council itself would be minor – temporary staff were already only used rarely for gap filling purposes, however they would need to set up a new formal process to record how and when they are used. This would result in extra costs due to having to hire more staff to monitor and keep track of this. The participant also considered that legislation could result in a move towards some subcontractors not recording their services properly, or being paid cash, to slip under the radar.

There could also be a move towards using larger businesses rather than PSCs to lessen the risk of penalties for non-compliance. This could bring its own problems and financial consequences “*we had a school in the borough that wanted their maintenance man to be a limited company, he could not afford it, so the school stopped using him and are now using a larger company that costs them much more*”.

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Case Study 3: SME**Managing Director of a cleaning company with national coverage.****Process**

Subcontractors were referred to as ‘suppliers’, and were used in areas where the company lacks a presence or did not have enough work to justify hiring a ‘full employee’. The employer tried to use suppliers that were familiar, but they did not really have a formal vetting process. New subcontractors were asked to complete a questionnaire which asked for business insurance details and ISO standards, but not whether a supplier was operating as a PSC.

The employer was fairly relaxed about looking into a company’s finances as they already looked at invoices and other documents. But they stated that to do so would be a very time consuming process.

Awareness

The idea of Intermediaries Legislation was completely new. The employer was unsure if it would apply to their subcontractors or not.

The employer understood other schemes, such as CIS, and their relevance due to the need to lessen informal payments often made in cash, but was less clear about the need for Intermediaries Legislation.

Responsibilities

The employer viewed the potential changes as a means of HMRC shifting the burden of checking tax. They stated the company was fully compliant, and already recorded all payments made through their accounts, which HMRC were able to check. They struggled to understand how their responsibility should be extended further - *“If someone invoices me, and I pay him, it’s not my responsibility to make sure he pays his tax”*.

Due to the nature of the business and many subcontractors working remotely at different occasions, the employer worried that the proposed change to legislation could result in having to employ new staff to monitor exactly how subcontractors were working. It would result in employers having to gather a lot more information from them, which constantly changed – *“also I need to know the profit margin of my supplier - he’s using resources, and to work out his tax I’d need to know what his expenses are, and how profitable he is.”* The employer stated that the potential change would result in their company avoiding using subcontractors, who would lose out by no longer being employed by SMEs struggling to manage new responsibilities. This in turn could have financial consequences for SMEs, as larger companies that had capacity to resource jobs in-house could take business away from them. In terms of implementing the change, the employer worried that HMRC did not give enough guidance on how to implement the reform to legislation, whilst still imposing the threat of penalties to those that don’t comply.