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Employment Status Report – follow up summary of responses

Introduction

In March 2015, the Office of Tax Simplification (OTS) published a report on Employment Status (ES). In the foreword to the report, interested parties were encouraged to comment on the conclusions. In particular we asked for further input on the subject of Office Holders (chapter 4): anyone experiencing problems or unexpected results was asked to respond.

This short paper summarises the responses the OTS has received since publication of the report. We also noted a wide range of press comments on the report when it was published: these were, pleasingly, almost universally supportive of the report and its ideas.

Office holders (chapter 4)

The ES report notes that the inclusion of the term 'office' within the ambit of income tax dated from the earliest days of the tax. It was suggested the term 'office holder' was outmoded and any distinction between that and 'employment' could be eliminated from the tax legislation. This would mean the tax treatment of any income from the activity would be taxed as employment income if the role was on general principles an employment but would otherwise be treated (presumably) as self-employment income.

Of course, if there were no problems in practice with the usage of the term office holder, then abolition itself could cause complexity in the short term.

Partners taking appointments

We received a submission that problems were increasingly being encountered in relation to members of professional partnerships being appointed as office holders, for example where acting as turnaround specialists. The impact is that the resulting income, rather than being accepted as part of the profits of the partnership, is treated as employment income of the individual appointee.

Chapter 3 of the ES report set out the terms of HMRC's extra-statutory concession A37 that enables such fees to be treated as trading income of the firm[1].

[1] Paragraph 3.17, HMRC employment income manual (EIM) 02500

The respondent's experience was that HMRC now take the line the concession does not apply where the individual, rather than the partnership, is appointed as the office holder. The concession refers to directorships in particular, rather than office holders generally.

The concession sets out that the fees may only be a small part of the profits. We heard that such an office holder as a turnaround specialist may employ 20-30 people who are then paid a salary out of the fee. The consequent fee is therefore large: indeed the gross fees may amount to 20% of the partnership income, and be regarded as too big to qualify for the concession.

Concessions are currently under review following the Wilkinson[2] decision, and there was support for the recommendation in the ES report for formalising this area for greater clarity.

Local Authority appointments

We also heard that HMRC have been reviewing Local Authorities for instances of individuals appointed by way of statute or regulation, and taking the line that this will constitute the holding of an office.[3] It was pointed out to us that a 'logic' problem of this approach occurs on numerous such posts, where the statute or regulation explicitly states the position is independent of the local authority. It therefore appears counter-intuitive to be then included on the payroll alongside employees of the authority.

We were told that some office-holders who then raise this matter with their own advisers have been told that this approach is incorrect, causing resentment and confusion and indicating a need to make sure the rules are better understood. The experience of Local Authorities who refer such examples to HMRC is that a non-committal answer is frequently given, which is unhelpful. A suggestion was made to include questions on office-holders within the ESI tool, to increase clarity in this area.

The respondent told us that a consequence of employment treatment of 'independent office-holders' is the barrier this is creating for recruitment, with a considerably reduced pool of individuals willing to work on this basis.

Voluntary workers

An unpaid office holder may receive home to work travel allowances. HMRC guidance[4] allows these allowances to be free of tax and national insurance contributions (NICs) where they do no more than meet expenses incurred and the total expense payments from the office fall below the rate of £8,500 per annum. Following the Finance Act 2015 abolition of the £8,500 limit for P11D expenses and benefits, we were told there is concern that all such payments may become assessable to income tax and NICs.

However, HMRC has confirmed to the OTS that there will be no change to their current published practice[5], something we would like to see publicised more fully.

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[2] R v Commissioners of Inland Revenue, ex parte Wilkinson [2005] UKHL 30

[3] HMRC confirmed this and said "HMRC has reviewed a number of statutory appointments and where such an appointment fulfils the requirements for an office to exist have correctly determined the appointment on this basis. However, if the appointment does not demonstrate the necessary criteria for an office to exist the appointment is determined using normal status indicators."

[4] Employment income manual (EIM) 71100

[5] One of the OTS's recommendations in the original Employee Benefits and Expenses report is that there needed to be a proper review of the position of (unpaid) volunteers' travel expenses. This was the major source of concern around the abolition of the £8,500 limit but our view was that this was an issue over

We were also informed that this problem occurs with volunteers appointed to Trade Unions, on detachment from their employers. The guidance above allowing tax/NICs free home to work expense payments only applies to **unpaid** office holders. We were told HMRC take the line that payment of an honorarium, intended to cover payments of small expense allowances, means the exemption would not apply. A call was made for a de minimis exemption of such a payment in deciding whether the office is unpaid.[6]

The original OTS work on Employee Benefits and Expenses quickly identified the £8,500 limit as ripe for abolition. A lot of our work focussed on the implications of abolition and the position of volunteers and their expenses was a key issue for many respondents. Our conclusion was that they had a valid concern, but that it was an issue around volunteers generally rather that the £8,500 limit. We recommended that new guidelines/definitions should be developed to cover volunteers' expenses if our main recommendation (for abolition of the £8,500 limit) was taken forward.

Financial loss allowances

A financial loss allowance (FLA) is a payment to cover loss of earnings. Examples of recipients are magistrates, individuals on jury service, and members of public bodies including the NHS. The issue seems to be an administrative one, rather than one of taxability, but it seems to arise in relation to office holders according to responses received.

HMRC guidance[7] states that provided the FLA payment is calculated to do no more than replace the salary that the recipient would otherwise have received from their employer, a FLA is not taxable as employment income.

A respondent told us that HMRC now wish to see expenses and receipts for FLAs; in their absence HMRC will treat the allowance as earnings for tax/NICs. However, unless the person is paying someone else, such a loss is impossible to prove. We were given an example within the NHS, where a locum may be covering the absence and simply reschedule their own workload to cover. There would then be no receipts to demonstrate the loss.

HMRC have advised that FLAs are being reviewed under the concessions programme, following the Wilkinson case.

Conclusion on Office Holders

Overall, this evidence supports the OTS's tentative conclusion in the original report that there is a need to review the rules and guidance around Office Holders.

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volunteers, not the £8,500 limit. If there is to be no review or change to their treatment, we think that is disappointing.

[6] The OTS understands that the point being made by the respondents is that they pay £X so that people do not claim travel expenses; the £X (or whatever it is) is estimated to be the likely travel costs incurred (they have no wish to allow people to make a profit out of it); but the result is that the individuals are taxed on the amounts. Hence the call for a de minimis amount. Of course they can drop the honorarium and reimburse expenses but that is more admin for them over small amounts – by trying to save admin they have simply created a tax liability where none should exist.

[7] EIM 01120

Link with employment law (Chapter 3)

We heard from a trade body who acknowledged the confusion that exists over status, and indeed considered this uncertainty to be the primary risk facing many self-employed workers. It was thought scope for manipulation of the rules (see also tax/NICs differences below) was a cause for concern of HMRC and HM Treasury. The respondent felt the issue can only be properly dealt with by adopting a joined up approach across tax and employment law, involving all relevant Government departments including HMRC, HM Treasury, the Department for Business, Innovation & Skills (BIS), the Department for Work and Pensions (DWP), the Pensions Regulator and the Home Office (for visa applications) to prevent escalation of the current problem where individuals fall within employment taxes yet have no entitlement to employment rights. Such a situation was considered by another respondent to be fundamentally unjust.

Rather than structural changes, the respondent felt that a panel of advisers who specialise in employment status should work closely with those enforcing the rules, to help develop greater clarity and transparency around the rules. It was also considered that the lack of tax/NICs risk for end hirers resulted in some of them not considering the correct status of the worker, particularly for lower paid and vulnerable workers, when commencing a new engagement.

Employment status indicator (ESI) tool (chapter 8)[8]

An industry representative also commented that updating and adapting the ESI tool seemed like a good idea, but thought it unlikely that it could be sufficiently accurate, transparent and reliable for the contractor taking the test on an ongoing basis. It was also thought that HMRC may be concerned that it would be manipulated in order to produce a preferred result.

A self-employed trade group said their experience of using the ESI was not positive, and it would need to be significantly changed to be of value to professionals and the self-employed.

Statutory employment test (chapter 9)

A respondent to the report was in favour of a court based approach, with guidance picking up on employment law principles established, rather than a targeted statutory test which could fail to achieve practical effect.

An industry representative commented that a simple short set of quantitative tests may be the only workable solution, but this could also prove to be draconian, dragging in too many contractors who are genuinely in business on their own account. It was considered the test would also need to replace IR35, and it was likely that enforcement would be very difficult.

[8] HMRC commented to the OTS that: "The customer experience of Employment Status Indicator Tool (ESI) has been unsatisfactory for some customers. Over the past year we have moved the tool to a new digital platform to solve the stability problems customers were experiencing. Future work is planned in the coming year to expand the ways in which ESI can support customers including making it more accessible and user friendly. Part of this work will involve user testing the new service to find out what works best to support customers."

Tax/NICs differences (chapter 10)

An accountancy body called for serious consideration to be given to aligning the NICs rates between employees and the self-employed, given the numbers moving into self-employment. Additionally, the alignment of benefits would also allow for a safety net for future entrepreneurs, mitigating the risk of starting a business and encouraging a greater appetite for going it alone.

A representative body commented that because employment gives a greater tax and NICs yield than self-employment, HMRC are likely to become involved in what should be a decision between the contractor and their client, and that their default argument will be for employment status. We were separately told by an accountancy firm that supplying services through limited companies within the NHS was resulting in tax/NICs avoidance.

Deduction of tax at source (chapter 11)

A tax consultancy firm put the concept of a construction industry type deduction at source (chapter 11) in pride of place for potential solutions, although a separate response from an accountancy firm commented this proposal would have major implications and that clarification would be needed on who would be caught.

Third way (chapter 12)

On the idea of a third way between employment and self-employment, a representative body commented they were looking to develop such a route themselves, and were planning to put forward a comprehensive proposal for discussion.

Conclusion and next steps

We are very grateful to the representative bodies, advisers and individuals who responded to the report. The range of comments we have received reinforces the evidence we uncovered in preparing the report, that there are indeed problems around employment status, and that further work is necessary on the routes set out to improve the position.

As always, we remain interested in hearing views from interested parties, and will be discussing with the new Government how best to take the review forward.

The Office of Tax Simplification **July 2015**