



KPMG response to HMRC's/HM Treasury's consultation on off-payroll working in the private sector

August 2018



1 Summary

- 1.1 We set out below our response to the joint HM Revenue & Customs ('HMRC') and HM Treasury ('HMT') consultation on off-payroll working in the private sector. We welcome the opportunity to contribute to the debate, including the opportunity to discuss our views on the various questions that have been raised.
- 1.2 In principle, we agree that there is a need to tighten the rules in relation to off-payroll working ('IR35') to ensure that the correct amount of tax and NIC is collected, given that the estimated cost of non-compliance with IR35 rules in the private sector is projected to increase from £700 million in 2017/18 to £1.2 billion in 2022/23. However, our overriding comment is that the action to be taken should be focused, proportionate and should take account of any wider reforms in the employment tax and employment law landscape that are currently being considered.¹
- 1.3 Further to the Taylor Review, the Government is consulting separately on the issue of employment status for employment law and tax purposes.² We consider that any major changes to the IR35 rules in the private sector, the taxation of the employed and self-employed workers and employment law should all be viewed through the same lens and considered holistically prior to implementation. Otherwise, isolated reforms may become too complex and costly for businesses to implement and comply with effectively. This would clearly be counter-productive.
- 1.4 We are not convinced that the lead option of extending the current public sector off-payroll working rules to the private sector is necessarily the right approach. However, our view is that if this option is adopted, it is vital that learnings are taken from the implementation of the reforms in the public sector and that HMRC fully appreciate the challenges arising in overlaying such reforms in the private sector.
- 1.5 Current figures in the consultation document set out that in any given month between April 2017 and February 2018 an additional 58,000 individuals paid tax and NIC, with an associated increase in remittances of £410m, as a result of IR35 reforms in the public sector. However, in our view, the impact of these changes should be assessed once a full-compliance cycle in the public sector has been reviewed, taking into account the self-assessment returns filed for the 2017/18 tax year. Only at that stage will Government be able to properly assess the success or otherwise of these changes, including the additional time and HMRC resource required to resolve disputes from Personal Service Companies ('PSCs') in respect of tax and NIC deducted by the fee payer and the net impact on Exchequer yield.
- 1.6 The public sector reforms highlighted a number of operational challenges which should be given full consideration if, ultimately, these rules are extended to the private sector. One of the biggest challenges facing the success of these proposals is determining employment status. The Check Employment Status for Tax ('CEST') tool was developed at a late stage to support the public sector reforms and has been subject to various iterations since. The consultation document outlines that a decision is reached in 85% of cases. Given the greater number of engagers in the private sector (compared to the public sector) that may wish to rely on the tool, in advance of any private sector reforms dedicated HMRC time and resource will be required to enhance the tool and take account of the nuances of the different business types in the sector.
- 1.7 The difficulty in evaluating employment status in IR35 situations has been demonstrated by recent First Tier Tribunal ('FTT') cases, underlining just how finely balanced decisions on employment status can be. Indeed, both *MDCM*³ and *Jensal Software*,⁴ have gone in favour of the taxpayer, suggesting that HMRC's approach, both in specific cases and in the algorithms embedded in the CEST tool, is not fully aligned with the IR35 legislation. However, where the dial is set on this matter feeds into the view of what is considered non-compliance and the associated estimated Exchequer yield. We would welcome more visibility on how these numbers and judgments have been arrived at in this context, e.g. whether *MDCM* and *Jensal*

¹ [KPMG response to the consultation on employment status](#)

² [Employment status consultation](#)

³ *MDCM Ltd v Revenue and Customs Commissioners* [2018] UKFTT 201 (TC)

⁴ *Jensal Software Limited v Revenue & Customs Commissioners* [2018] UKFTT 271 (TC)

Software would have been considered to be cases falling within the estimated 90% non-compliance.

- 1.8 Notwithstanding our suggestions for enhancements to the CEST tool, there remain limitations with this approach for establishing employment status within the confines of a rigid series of questions. Outside of more routine circumstances, we anticipate this will continue to be an area of difficulty for both taxpayers and HMRC. The definition of employment status falls outside of the remit of this consultation, however, we consider that until this is much clearer than a tool like CEST can only ever be an approximation to an answer for IR35 purposes. Marginal cases will always be difficult, and we think that where the fee-payer makes the decision this will inevitably lead to disputes and appeals.
- 1.9 More specifically, given the potential for tax and NIC liabilities, as well as the imposition of penalties, if the lead option or similar proposals are adopted, a naturally conservative approach to the rules may be the 'default position' for some businesses. At the other end of the spectrum, others may apply the rules more leniently, which may result in an arguably inappropriate competitive advantage distorting the objective of a level playing-field. Issues such as blanket rulings, a clear appeal route against decisions made by the fee-payer and what constitutes 'reasonable care' all need to be fully considered, with clear guidance required in advance of any reforms to avoid an unnecessary administrative burden for business, workers and HMRC.
- 1.10 Any reform introduced as part of this consultation will need to take full account of the lead time that businesses will require to implement and test the necessary systems, processes and controls required to support compliance with the rules. Discussions regarding the proposed reforms with our large corporate clients have revealed that it would take at least 18 months to properly plan for and implement the lead option, with the cost of implementing such changes running to six figures or more.
- 1.11 Given the strong sentiment around the timing of the introduction of reforms in the public sector, we firmly believe that the Government should allow businesses enough time for any significant changes in the private sector. The timing should also take account of the learnings from a full compliance cycle of the public sector reforms (including self-assessment returns due to be submitted in January 2019). Therefore, we believe that April 2020 is the earliest date at which the introduction of any such reforms should be considered.
- 1.12 This said, we believe that there may be a better and more straightforward approach to achieving compliance with IR35 in the private sector than that identified in the lead option. This is to institute a requirement for periodic reporting by engagers of payments to PSCs, coupled with enhanced reporting requirements for workers with PSCs under self-assessment in terms of assessing the IR35 position. Furthermore, elevated penalties may be appropriate for non-compliance, coupled with joint liability for any PAYE/NIC that may be due where the IR35 rules are in point. Given the estimated level of non-compliance, HMRC might also require completion of the CEST tool or other equivalent white space disclosure detailing why IR35 does not apply. Accompanied by suitable publicity, we believe that this approach would significantly raise the profile of IR35 and the importance the Government attaches to people paying the appropriate amount of tax in the circumstances. It should also allow HMRC to focus its resources on cases where they may consider that further investigation is required.
- 1.13 Our specific comments on the questions posed as part of this consultation are set out below. Further to our responses to wider consultations, including our response to the Government's recent consultation on employment status,⁵ we would welcome a discussion on the broader areas of how labour should be taxed in the 21st Century once the Government has considered the responses received to those consultations. A joined-up, forward looking approach would be welcome in the current economic climate.

⁵ [KPMG response to the consultation on employment status](#)

Response to HMRC/HMT Questions

1 What could be done to improve the compliance enquiry process to reduce non-compliance, whilst safeguarding the rights of customers?

- 1.1 We consider that there are various ways in which the existing processes could be bolstered, including:
 - a. Where a taxpayer indicates that they have a PSC⁶ on their tax return, more questions could be asked around whether any deemed IR35 payment should have been accounted for, and if not, the reasons why this is believed not to be the case;
 - b. Recognising that the existing IR35 provisions require the PSC to account for PAYE, the Government could consider a change in legislation, whereby for example, the individual providing their services via a PSC is jointly liable for any PAYE found to be payable (this could also extend to cover liability for primary and/or secondary NIC);
 - c. Furthermore, there might be a rebuttable presumption that IR35 applies to all engagements unless the PSC/individual can demonstrate that it falls outside the scope of the IR35 provisions.
- 1.2 Taking this a step further, HMRC could then set out in their guidance the form of evidence it requires to substantiate that IR35 does not apply, e.g. the contract between the PSC and end-user and an analysis of the fact pattern of the engagement to support self-employment. This may include input to and output from the CEST tool, providing that the realities of the engagement remain constant over time.
- 1.3 Following the approach of the intermediaries legislation, quarterly reporting by engagers could also assist HMRC in identifying cases for review.
- 1.4 Although HMRC has undertaken enquiries and enforcement action into non-compliance in respect of off-payroll working, given HMRC's resource constraints, it is questionable whether these have been extensive enough to materially improve compliance against the scale of non-compliance outlined in the consultation document. Indeed, the consultation document does not provide figures in support of the level of activity undertaken. This is a complex area. As such, a targeted awareness campaign and publicity of the cases and sectors that HMRC are focusing on will be required, perhaps combined with a disclosure facility in respect of historic non-compliance.
- 1.5 If the above targeted approaches were not considered sufficient in engendering compliance, consideration could also be given to elevated penalties. The level of such penalties would need to be considered to match the nature of non-compliance. Under recent legislation, such as the Criminal Finances Act 2017 and Requirement to Correct, the penalty regime is indeed stringent.
- 1.6 In respect of the challenges faced by HMRC regarding the winding up of PSCs before liabilities have been collected, consideration could be given to the insolvency rules that apply in such circumstances and the potential transfer of PAYE/NIC liabilities to the directors of such PSCs as and when that may be appropriate.

2 Could the public sector regime better fit the needs of businesses? How?

- 2.1 Given the sheer scale and complexity of introducing the off-payroll working rules into the private sector, we consider that there are a number of issues that would need to be overcome in order to ensure that any reforms in the private sector would be fit for purpose. In this regard, it is important to consider the learnings from the implementation of the off-payroll working rules in the public sector. We believe that the Government could make improvements to the public sector regime in respect of the financial implications on businesses, administration and timing. We have expanded on these points below.

⁶ The legislation at Income Taxes (Earnings and Pensions) Act 2003, Chapter 8 Part 2 refers to Intermediaries. For simplicity in the document we have used the term PSC, although the term intermediary is much broader in its application to those captured within the rules.

- 2.2 The research upon which HMRC based its assessment of the case for extending the off-payroll working rules was undertaken at an early stage. For example, survey fieldwork in [‘Off-Payroll Reform in the Public Sector, HMRC Research Report 487’](#) was undertaken between August and October 2017, and is quoted as reflecting public bodies’ ‘very early experiences’. In addition, the PAYE data supporting the number of individuals paying income tax, National Insurance, and associated Exchequer revenue was based on the first 10 months of the reform (April 2017 – February 2018). An extensive post-implementation review of the reforms has not been undertaken, which we would expect to be done in relation to a reform of this magnitude.
- 2.3 Indeed, at this stage, the compliance cycle for the 2017/18 tax year has not yet completed as tax returns for this period have yet to be filed. It is therefore likely that there will be enquiries into and appeals against determinations made following the submission of tax returns by 31 January 2019. It is only once these have been resolved that a proper assessment of the reforms in the public sector can be undertaken, including overall Exchequer yield arising from the reforms and HMRC resource required to deal with disputes arising in respect of the end client’s decision for tax and NIC to be deducted by the fee payer.
- 2.4 We have talked to our clients across the public sector and the key issues they have experienced since the introduction of the rules regarding off-payroll working in the public sector are summarised below:
- a. Identifying the relevant engagements that are caught by the off-payroll working rules, not least identifying which entities are PSCs and which are not;
 - b. Disputes between the client and end-user, PSCs and their advisers on the application of IR35. For example, concerning the efficacy of substitution clauses;⁷
 - c. There was a lack of availability of commercial software to account for income tax and NIC following receipt of a PSC invoice. In respect of introducing the off-payroll working rules in the private sector, HMRC should be looking to liaise with providers to assess the possibility of licensing software by a practical implementation date of April 2020. HMRC needs to provide, or assist in the development of, payroll software specifications that enable ‘deemed employees’ to be distinguished from true employees in payroll submissions to HMRC;
 - d. Additional costs of engaging PSCs via an agency where it was not possible for the end-users’ systems to apply PAYE and NIC to invoices received from PSCs. Client feedback suggests an increase in costs of c.6%;
 - e. There was some evidence of contractors’ rates increasing to absorb the income tax and NIC suffered as a result of the application of the IR35 rules. The private sector would need to be able understand and factor such costs into their operating models and budgets;
 - f. There was some evidence of contractors withdrawing from public sector work and moving to the private sector in cases where they disagreed that their engagements would fall within IR35, or where the decision-making was taking too long. Introducing similar changes in the private sector would be likely to rekindle conflict and dispute amongst these contractors which may ultimately play out in the FTT;
 - g. The public sector reforms were introduced in a short timeframe, with less than 6 months from confirmation in the Autumn Statement 2016 to the reforms coming into effect from April 2017. A function of the shortened timescale for reform was that the CEST tool was not available until a late stage and required amendment after its release. Furthermore, the reforms were not sufficiently publicised; we understand that some PSCs and their advisers appeared unaware of the April 2017 changes. These experiences around the timings of the reform suggest that the private sector requires an appropriate lead in time to ensure they have robust processes and procedures in place to comply with the rules. For the reasons set out here and at question 5 we believe that April 2020 is the earliest date to consider any such reforms;
 - h. In some cases where the CEST returned a ‘not determinable’ verdict (this is currently stated in the research paper to be 15% of cases), HMRC’s helpline was not felt to provide adequate support. Investment in the CEST tool to improve its verdicts and reliability for

⁷ As HMRC will be aware, this is a difficult issue and one that was considered in more detail in *Jensal Software*. See footnote 4.

businesses is required to engender more confidence in the tool. However, with the multitude of different types of work in the private sector it is questionable whether this is possible given the present case law approach to determining what is 'employment'. We elaborate below.

- 2.5 In respect of points (g) and (h) above, the CEST tool is aimed at providing a user friendly approach to determining employment status in what is a complex area. In reality, case law has set out that all of the factors surrounding the engagement should be considered (including mutuality of obligation). The formulaic approach taken by CEST of asking a series of limited questions might not necessarily result in the 'right answer', as it cannot identify and assess the nuances of specific circumstances. Whilst for routine cases this may be satisfactory, the FTT highlighted in the recent IR35 case involving *Christa Ackroyd Media Ltd*⁸ that reaching a conclusion: '*is a value judgment. It is in the nature of a value judgement that different people may come to different conclusions*'.⁹ Other recent FTT decisions such as *Jensal Software* and *MDCM*, which were held in the taxpayers favour highlight how finely balanced such decisions can be. Indeed, it is not clear how these decisions would fit with the CEST tool determinations outlined above, or more broadly with the figures on non-compliance quoted in this consultation.
- 2.6 Notwithstanding the above comments, given the magnitude of extending the public sector reforms to a diverse private sector, the number of cases which are 'not possible to determine' is likely to increase. One approach could be to address the configuration of, and input into, the CEST tool to reduce the number of such cases. Albeit this should be done without placing an undue burden on businesses to provide even more information as this could be time consuming for all stakeholders in the process. As noted above, we are not convinced that the problem of 'not possible to determine' cases is readily solvable.
- 2.7 Given the complexities of employment status outlined above, we envisage that there is the potential that businesses will naturally tend to make conservative determinations in considering the scope of the new rules, i.e. to avoid potential of tax and NIC liabilities together with associated penalties arising as part of any future HMRC compliance review. However, such an approach could result in a flood of appeals, which could overwhelm the FTT/HMRC and pull in resources at a time when there are many other demands. This is clearly not the intention of the proposals outlined in the consultation, but we think this is something that needs to be considered very carefully when considering whether, and on what basis, to proceed with the lead option.
- 2.8 Furthermore, the issues raised in this consultation and the wider definition of employment status are intrinsically linked. As such prior to reform, further soundings should be taken from the findings and recommendations from the Taylor Review¹⁰ and responses received to the current Government consultation on employment status to ensure any changes are fully rounded and coherent in their application to both workers and engagers. It should be noted that the wider discussion on employment status and entitlement to worker rights was absent from the off-payroll working in the public sector discussions and is still outstanding. To address the disconnect between the legal and tax position, we propose that, further to an update to the employment status test, where an individual whose services are supplied through a PSC is found to be an employee from a tax perspective, that assessment should also be applied to determine whether they benefit from employment law rights, ignoring the corporate vehicle.

3 What if any, changes could help make the administration as simple as possible?

- 3.1 Please see comments included at question 2. The impact of the lead option is likely to create a disproportionate cost and administrative burden on smaller businesses, and this aspect needs to be carefully considered. In particular, such businesses will need to institute processes to identify PSC cases, assess whether IR35 applies, relay the decision to the PSC, deal with any resulting dispute, adapt contracts accordingly and either operate an additional, separate payroll or outsource this to a third party. This will result in material costs in terms of resources or fees for these businesses.

⁸ *Christa Ackroyd Media Limited v Revenue & Customs Commissioners* [2018] UKFTT 69 (TC)

⁹ [2018] UKFTT 69 (TC) [180]

¹⁰ [Good Work: The Taylor Review of Modern Working Practices](#)

3.2 We believe that the consultation document misses the opportunity to explore areas that would facilitate simpler administration. For example, wider proposals around recasting the employment status tests, which are fundamental to informing any reforms in this area, or consideration of the minimum length of engagement.

4 If the private sector rules were changed, do you have any evidence that there are parts of the private sector where the administration of any regime may need to vary even though the basic principles including for determining status, remain the same?

4.1 As already outlined, employment status is a complex and challenging area, and is one that both engaging parties may not agree on (or indeed a PSC, agency and end-user may not agree on). Any reforms would need to ensure that employment status can be properly assessed across the many facets of the private sector (all sectors will have their own nuances), in a straightforward and cost-efficient manner. Recent cases such as *Jensal Software* and *MDCM* highlight the difficulties faced in determining such issues, which need to be considered.

4.2 As a further example, the Supreme Court decision in *Pimlico Plumbers*¹¹ demonstrates the increasing difficulty of determining whether someone is employed or self-employed. Although this case was played out against the backdrop of the gig economy and did not include a PSC, it is interesting that the tax treatment of the individual was that of self-employed even where he essentially worked exclusively for a single engager and appears to meet a number of the traditional employment tests, even though he was found to be a 'limb (b) worker' under employment law.

4.3 This demonstrates the complexity around employment status and supports an argument that the term 'employment' should be aligned across tax and employment law to facilitate better understanding and transparency. The Taylor Review highlighted this in detail and we entirely agree that how someone is categorised should be clear and unambiguous, so that everybody knows where they stand.

4.4 More generally, there is a real question as to whether it is possible to equate the introduction of the off-payroll working rules in the public sector to their introduction in the private sector, either in terms of cost or the resource required to implement the changes. The number of different business models and type of business in the private sector is not comparable to the more limited number of business models in the public sector. There will inevitably be challenges and complexities faced in the private sector that may not have previously been encountered in the public sector. Therefore, although one can take certain learnings from a post-implementation review in the public sector, the number of engagements and complexity in the private sector will render the administrative challenges more acute. For example, HMRC agreements with the Film and TV sector as to whether individuals are to be categorised as employment or self-employed, and this will need to be factored in.

5 Is there any evidence that parts of the private sector will not have, or be able to acquire the administrative capacity, knowledge and resources to enable them to implement any changes in relation to off-payroll workers?

5.1 In overview, the private sector will need to consider a number of areas in order to implement the changes and involve a number of stakeholders, including tax, finance, HR, legal and procurement. The timescale in which such changes are introduced will impact on the immediate level of administrative capacity, knowledge and resource required to successfully implement any changes. The shorter the timescale, the more acute the issues. The scale of activities that the private sector will have to undertake is detailed further in our response to question 10. The resulting administrative burden will apply equally to smaller firms who are resource constrained as well as to larger businesses who may have tens of thousands of contractors and will need to scale up to identify and assess the relevant populations.

5.2 The private sector will also need to consider insourcing or outsourcing in order to meet the requirements of a deduction at source model, depending on their assessment of the above points, introducing additional costs for the business. We have received representations from our clients that if sufficient lead time for reform is not provided, they will not have the administrative

¹¹ *Pimlico Plumbers Ltd v Smith* [2018] UKSC 29

capacity and resource to acquire knowledge and implement the system changes that will be required to comply with any new legislation, and additional costs of outsourcing are likely to be incurred. Categorisation of who is caught by IR35 and who is not is also likely to be more haphazard, resulting in more disputes and appeals.

- 5.3 If the rules are intended to apply equally to smaller entities as to larger ones, clearly there will be a disproportionate impact on smaller businesses. Indeed, the £7,550 estimated set up cost for public bodies stated at 4.23 in the consultation is a substantial sum for certain SMEs, and the Government should recognise that there are few recognised employment specialists within large businesses, let alone smaller ones, to drive through these reforms. Furthermore, we consider that the £7,550 sum is likely to be understated given the time and effort required to properly assess which entities are PSCs, to properly analyse whether IR35 applies and then explain/debate the position with the worker.

6 How could these difficulties be mitigated?

- 6.1 As we have highlighted in the responses to the previous questions, the key issues in implementing reform revolve around the administration, effort and cost to businesses. Given the issues involved, it is difficult to see how these difficulties can be mitigated to any substantial degree. Nevertheless, having a fully-resourced HMRC team available, as well as clear, considered guidance (well in advance of any changes being introduced) would be essential. Indeed, it should be recognised that HMRC's workload arising from the implementation of the rules in the private sector will be much greater than for the public sector.
- 6.2 There is a broader issue of considering the test for employment status across employment law and tax in the context of the Government's recent consultation on employment status and last year's Taylor Review. There is an intrinsic link between the issues raised under IR35 and the boundary of employment/self-employment that was subject to that consultation. Accordingly, an approach that is aligned across employment law and tax to redefine the term 'employment' could make it easier to operate the CEST tool for IR35 cases. We are of the view that IR35, taxation of employed/self-employed and employment law should all be viewed through the same lens and considered together. Indeed, this consultation provides another opportunity to address this in the context of the sheer variety of work across the private sector. Given the overlap between these areas, if system changes are required to address a series of changes around IR35, employment status and wider legal rights, this would inevitably increase business costs against a backdrop of Making Tax Digital and uncertainties around Brexit. We think this is an important consideration which should not be overlooked.

7 What aspects of policy design might be adjusted if similar changes were brought in for the private sector? Should we bring in a specific penalty if agencies fail to comply?

- 7.1 Where agencies appear not to be discharging the responsibilities imposed on them under the PAYE legislation, it is unclear why HMRC would not apply the full range of powers already at its disposal to investigate why this is and apply sanctions as and where this is appropriate. We recommend that HMRC review the relevant cases in detail as there may be important learning points here as regards the way the scheme is operating (or not) in the public sector. We have discussed a number of other policy issues arising in relation to the public sector rules in questions 2-6 above.
- 7.2 The side effects of any change in legislation should also be considered, as one of the outcomes may be to move to other labour models, such as umbrella companies, where compliance might be more difficult to enforce.

8 What action should be taken in the case where the fee-payer hasn't acted upon the client's conclusion that the worker would have been regarded as an employee for income tax and NICs purposes if engaged directly? Should an obligation be placed upon the fee-payer to adopt the client's conclusion and there be sanctions for failing to do so?

- 8.1 We are of the opinion that the fee-payer is entitled to their view of whether an engagement falls within the scope of the rules and should not be penalised simply because they have come to a different view to that of the client. Echoing our comments at question 2, the determination as to

whether an engagement falls within the remit of IR35 is a 'value judgement', and the fee-payer may have reasonable grounds for taking the view that IR35 does not apply. That being said, there should be a clear rationale as to why a different conclusion has been reached.

- 8.2 Employment status is a notoriously complex area and it is entirely possible that two parties reach a different conclusion, both having taken a reasoned approach. It is a question of weighing up the position in the knowledge that penalties will be imposed if a party has not applied the rules where required to do so.
- 8.3 One further point to consider is that 'reasonable care' is not defined in the legislation. Therefore, a stakeholder could contend that they have exercised reasonable care to the expected standard in reaching an IR35 decision in order to avoid any liability where a different conclusion might have been reached on the facts.

9 What action should be taken if the worker or PSC is knowingly receiving income that has not had the right amount of tax and NICs deducted?

- 9.1 Outside the provisions set out in the Criminal Finances Act 2017, we envisage that a mechanism similar to that set out in Regulation 72(4) PAYE Regulations should be established to allow HMRC to recover underpaid income tax from the fee-payer and the individual where necessary. A similar approach should be considered in respect of the NIC position.

10 What systems and process changes would businesses need to make?

- 10.1 If a similar approach is adopted to the rules in place in the public sector, then we anticipate that businesses in the private sector, regardless of size, would be required to undertake a costly exercise to identify all engagements with PSCs to assess whether they fall within the scope of IR35.
- 10.2 One-off costs will include making system changes (i.e. system selection, system specification testing etc.), identifying key stakeholders and undertaking the necessary training – at all stages in the process, identifying the impacted contractor population and relevant communication of the changes with suppliers, conducting gap analysis, drafting and re-writing policies and considering the governance framework as well as establishing the cost impact of the changes (e.g. contractors seeking to increase their rates where deductions will be made).
- 10.3 Furthermore, there are ongoing costs that would include the time taken to establish employment status for the relevant engagements (and dealing with associated disputes/interaction with HMRC), payment and reconciliation processes, reviewing HR/talent process and increased employer's NIC costs.
- 10.4 As we highlighted in our response to question 2, there is presently a lack of available software which is able to integrate PAYE, off-payroll working and VAT considerations and this would need to be remedied.
- 10.5 A number of businesses will have to make system changes and HMRC will be aware that these are not necessarily simple exercises. A number of our larger corporate clients have estimated that 18 months' lead time is the minimum time required to ensure businesses are ready to comply with significant changes to the rules. Indeed, as HMRC will be aware, system changes can take a number of years from planning and budgeting to inception. Furthermore, most large businesses that have discussed their views with us are estimating costs of six figures or more to reconfigure their systems and processes to ensure compliance with the new rules when they come in. The costs, processes and systems changes required in the private sector will vary quite significantly from those set out during the public sector implementation (i.e. an average implementation cost of £7,550, albeit we think this is an underestimate).
- 10.6 As a wider point, businesses would need to consider their engagement model to accommodate an ongoing process to link procurement, HR, accounts payable and the finance/tax team to co-ordinate what to do when a PSC is engaged. In order to properly implement the new rules, clear processes will also need to be implemented by the end-user to reduce the possibility of any disconnect between the business and the front-line individuals making the status determination.

11 Would there be any process and administrative cost implications for businesses? Can you provide evidence of the scale and nature of these?

- 11.1 There will be a significant process and administrative cost implications for businesses in the private sector. Information on the scale and nature of the implications is available from HMRC's introduction of the new rules in the public sector, albeit this does not include any challenges around the PAYE/NIC categorisation for IR35 purposes when the 2017/18 tax return is submitted by the individual. The public sector is also more homogenous and the sheer variety of different work undertaken in the private sector is likely to add significant complications and resulting additional cost
- 11.2 We have outlined a number of implications in the responses above. In addition, businesses' and HMRC's resources may be consumed by boutique firms offering their services to assist workers with PSCs to fight their cases in the FTT. The *MDCM* and *Jensal Software* cases illustrate that they may well be successful so have little to lose in this respect.

12 Can you provide any evidence that these costs would vary depending on how much notice businesses were provided for the introduction of any reform?

- 12.1 We have received feedback from larger clients estimating that an 18 month period is required to effectively implement processes and procedures to address any IR35 reform in the private sector.
- 12.2 Were changes to be introduced in a shorter timeframe, businesses may not have sufficient time to properly test and implement robust processes which could result in higher costs due to non-compliance. Additionally, the shorter the timescale, the more likely it is that the business will be required to outsource in order to meet its compliance obligations.

13 Is there anything else HMRC could do to ease the implementation for businesses, and can you provide evidence of how this would ease implementation or administration for businesses?

- 13.1 As outlined above, the CEST tool is currently designed for engagements in the public sector, and in our view will need to be adapted for private sector organisations. We consider that HMRC would need to invest resources in improvements to the CEST tool, and in further specialist support where the result of an engagement enquiry is 'cannot be determined' so as to guide employers through the rules. Clear guidance would also need to be developed with a large variety of scenarios that reflect modern working practices. Rolling out the public sector changes would have a significant effect on the private sector and therefore we believe it is only right that HMRC publishes enough material and has made sufficient resource available to enable employers to make a considered and informed decision. However, we are not convinced that this will be sufficient to prevent disputes and disagreement spilling over into the FTT.
- 13.2 In particular, we have received representations from a number of our clients that the CEST tool is neither representative nor robust enough to provide accurate determinations on employment status. It is worth reiterating that HMRC has lost several recent court cases in respect of off-payroll working and IR35. If HMRC is being defeated in the courts and their view of IR35 is the foundation of the CEST tool, then there must be a question as to whether the tool is currently accurate.
- 13.3 We would reiterate our comments that an approach that is aligned across employment law and tax to redefine the term 'employment' could make it easier to operate the CEST tool for IR35 cases.

14 Overall, what are your views on this option (to encourage or require businesses to secure their supply chains)? Would it be a proportionate response to the issue?

- 14.1 Our view is that it is certainly in the best interests of businesses to ensure that their supply chain is compliant to address the variety of fiscal and reputational risks. The checks outlined in HMRC's guidance are a useful starting point, and inserting contractual clauses requiring labour suppliers to evidence PAYE filing and payments to HMRC is best practice. As a general

comment, the consultation document notes that the decision is still left with the PSC and, therefore, on its own this approach does not necessarily tackle the compliance challenges noted by HMRC in the consultation.

- 14.2 Nonetheless, we believe there are steps that private sector businesses can take to tackle non-compliance without a disproportionate administrative burden. For example, consideration should be given to a quarterly reporting regime, in the same mould as that in place for employment intermediaries reporting, where engagers or agencies provide HMRC details of payments made to PSCs every three months. To bolster this reporting process the engager might also be required to provide a CEST report to evidence whether the business considers the engagement with the PSC to fall within or outside the remit of IR35. This would provide HMRC with a clear audit trail and evidenced decision-making process after the end of the tax year should HMRC require further details.
- 14.3 Parallel to this, HMRC could require the worker of a PSC to provide considerably more information on their Self-Assessment tax return where IR35 is not being operated. A link to the relevant guidance, the CEST tool and the associated penalty regime could be provided to ensure the worker is fully aware of the consequences of not applying the legislation where required. Indeed, penalties could be increased in this regard so conveying the Government's commitment to ensuring proper compliance in this area. Furthermore, consideration could be given to making the worker jointly liable for PSC debts should IR35 not have been operated where required. Undoubtedly, this would encourage more focus on ensuring that IR35 rules are observed and the right amount of tax is paid. Furthermore, it would do so in a way which would not add to the administrative burden on business, as would the lead option.

15 If the government were to pursue this option, what checks should the client be required to perform?

- 15.1 Please refer to our response to question 14. There a number of checks that could address the compliance challenges, such as those in place for the engagement of overseas contractors.

16 How should different views on employment status be dealt with? For example in the public sector, disputes should be resolved between the client and the worker, which ultimately allows either party to walk away if they do not agree.

- 16.1 We consider that a reasonable and proportionate approach, as set out in question 14, may be to impose a reporting requirement on businesses in respect of the payments it makes to PSCs, as well as providing the input and output of the CEST tool. This would allow HMRC to address any issues directly with the PSC or worker.

17 How would HMRC best enforce compliance with securing labour supply chains, keeping in mind the need to mitigate or reduce dealing with each PSC individually?

- 17.1 We think that this approach needs to be recast as suggested in our response to question 14. Our suggested alternative approach would inform HMRC on a regular basis as to which businesses have engaged PSCs, how much they have been paid and the CEST assessment of the engagement. In conjunction with the requirement on the worker to report under self-assessment, this should enable HMRC to enquire effectively into PSC arrangements to determine if the IR35 provisions have been properly applied.
- 17.2 It is worth highlighting that, even where a deduction at source model is applied, this does not take away from the need for HMRC to examine circumstances on a case-by-case basis where there is a dispute between the parties on whether a deduction was appropriate. It simply 'kicks the can down the road' to the point where cases are taken to the FTT.

18 Should the requirement be underpinned by some form of penalty?

- 18.1 A considered penalty regime that encourages compliance and consideration of the IR35 provisions down the supply chain signals that HMRC is committed to enforcing the rules. We consider that penalties in line with those already in force for the quarterly reporting of employment intermediaries are an appropriate starting point. Furthermore, in line with our

response to question 14, consideration could be given to making the worker jointly liable for PAYE/NIC owed by the PSC should IR35 not have been operated where required.

19 Should the requirement be underpinned by denying the client a deduction for the cost of labour from an unchecked supply chain?

19.1 No, we think this would add further complication and uncertainty. Please also refer to our response at question 18.

20 Should the requirement be underpinned by the risk that the client could be named as having used a non-compliant supply chain?

20.1 We believe that it is unreasonable to assume that the client has the power to secure compliance with the IR35 provisions down its entire supply chain. Therefore, a naming and shaming policy may be a disproportionate response to isolated occurrences of non-compliance in a complex area such as determining employment status. That said, and in relation to a quarterly reporting regime which we refer to at question 14, a penalty regime should be considered with elevated and more onerous penalties in scenarios where there is a repeated failure to provide HMRC with the requisite information. A naming and shaming policy may also be appropriate for non-compliance with such a reporting regime.

21 Would such penalties effectively change behaviour within labour supply chains, helping to ensure the correct income tax and NICs are paid?

21.1 In line with our response to the question 20, a naming and shaming policy, similar to that in place for National Minimum Wage, for repeated instances of clear non-compliance with requirement to report payments made to PSCs, as well as a robust penalty regime would be an effective strategy to focus compliant behaviour within labour supply chains. Particularly in light of the need to reduce the estimated tax gap of £1.2 billion a year by 2022/23.

22 What would the impact (including the effect on administrative burdens) of this option be on affected businesses, agencies, and individuals?

22.1 Given that an estimated £1.2 billion of tax a year by 2022/23 is at stake, we consider that the administrative burden imposed by the approach we propose in our response to question 14 is manageable and proportionate.

23 How effective would this option be in addressing non-compliance with the off-payroll working rules in the private sector?

23.1 We believe that the proposals as they stand set out at 6.14 to 6.20 of the consultation will have a limited effect in addressing non-compliance. However, we have set out our views above in respect of further measures and steps that could be taken to make the proposals more effective and materially increase compliance.

24 Is there any way to improve this option which would make it more effective?

24.1 Please refer to our response to question 14.

25 Overall, what are your views on this option (to require businesses to retain certain records)? Would it be a proportionate response to the issue?

25.1 Under this option, clients making payments to PSCs would have to retain records relating to off-payroll arrangements (contracts, shift rotas, line management reporting etc.). For most businesses we anticipate that these records should already be readily accessible and retained by the business to support on-boarding and audit purposes. We believe the administrative burden of this option is no greater than that already shouldered by HR, procurement and finance teams in the private sector, albeit if HMRC was to introduce a record-keeping requirement one would assume this would also refer to the quality of the information kept.

Therefore, we do not believe this would be a disproportionate response as many businesses will already have a record-keeping process in place.

26 If the government were to pursue this option, what information should be required to be gathered?

26.1 We envisage the contract (including any extension/variation), invoices, timesheets, line management reporting details and a copy of the CEST input and output at the start of the engagement should be collated, and again if the engagement terms change. In addition, we would expect business-specific working practices to be detailed.

27 How could the government ensure that others in the labour supply chain pass accurate and timely information to the client?

27.1 Further to our comments above, we believe that this information should already be readily available. Nonetheless, one approach to ensure that accurate and timely information is passed to the client is to provide for the inclusion of a contractual commitment at the start of the engagement to provide all requisite information.

28 What penalties should fall on the client or others in the labour supply chain if they fail to comply with the requirement?

28.1 Further to our response at questions 26 and 27, we believe that this information should already be readily available, but if it were not then the client should include a contractual provision from the beginning of the engagement to require that it is provided. We consider that any 'penalties' could be captured under the commercial terms agreed between the parties, such as a withholding of payment from the client to the PSC where information has not been provided in a timely and accurate manner.

29 What would the impact (including the effect on administrative burdens) of this option be on affected businesses, agencies, and workers?

29.1 We do not consider that this option would have an adverse impact nor place an undue administrative burden on affected businesses, agencies or workers. As referenced in our previous responses, this information should already be readily available within the business and a contractual provision could be included in the agreements between the parties to provide all relevant records upfront.

30 How effective would this option be in addressing non-compliance with the off-payroll working rules in the private sector?

30.1 Additional record-keeping requirements will not, in our opinion, be enough to address non-compliance in isolation. However, it would be helpful for HMRC to have this information should it want to pursue a PSC for non-compliance with the IR35 rules.

30.2 However, we propose combining this option with the second option, as we have suggested it be recast – see our reply to question 14. This would include a regular reporting requirement by businesses to HMRC of payments made to PSCs. We believe this would be a powerful tool by which HMRC could effectively tackle non-compliance in a proportionate and focused fashion, making material inroads to the estimated £1.2 billion per year of tax understood to be at risk by 2022/23.

31 Is there any way to improve this option which would make it more effective?

31.1 Please refer to our response at question 30.

32 Are there other options, within the scope of this consultation as set out in Chapter 2, that would be effective ways of tackling non-compliance in the private sector that the government should consider (for example, possibly drawing on lessons from other countries)?

- 32.1 Yes, we believe that there is an alternative approach to securing compliance in this area and that the Government should give consideration to this before extending the public sector reforms to the private sector.
- 32.2 A mechanism whereby (i) businesses regularly report PSC payments to HMRC, provide CEST input and output from the engagement, retain appropriate records and (ii) workers must address the question of PSC work much more fully in their tax return could result in a much less burdensome compliance environment for businesses and an effective means of protecting IR35 revenue. Strengthened by an enforced and elevated penalty regime, this mechanism could allow for much more informed targeting of arrangements by HMRC that are potentially non-compliant.
- 32.3 This approach would avoid a potentially large number of appeals to the FTT by workers objecting to being subject to PAYE withholding. The *Christa Ackroyd* and *MDCM* cases demonstrate the finely balanced circumstances on which IR35 decisions can be made, and while the Government may be attracted to the idea of having businesses police IR35 compliance, the amount of HMRC time and resource required to unpick a number of cases on appeal is a real concern.

33 Would these, or any of the other options outlined above, be more effective than extending the public sector reform? If so, how would they be more effective and on what grounds would they be preferable to extending the public sector reform?

- 33.1 Please refer to our response to question 30.

34 Are there any other issues which businesses or individuals who may be affected would like to raise?

- 34.1 A key issue for taxpayers is a fair and transparent tax system that allows them to understand their tax affairs. We believe that HMRC would agree that the IR35 rules are already complicated for businesses, and that the public sector reforms have added to this by requiring PAYE to be deducted at source such that a net payment is remitted to the PSC, the worker is treated as an 'employee' yet receives no pay and the business accounts for the employer's NIC liability. We would contend that this is far too complex for the average worker with no tax technical expertise to understand, a situation made more complex when considering that many workers will have multiple engagements to consider, some in and some out of IR35.
- 34.2 Therefore, we consider that the Government should take these complexities into account before applying the public sector reforms into the private sector. There are alternative approaches, discussed in this response, which we believe could also effectively tackle the estimated £1.2 billion a year tax leakage by 2022/23. We encourage the Government to properly assess the implementation of the public sector reforms over the next year, in conjunction with alternative approaches and feedback from this consultation, before introducing similar reforms to the private sector.

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