

# Office of Tax Simplification

**Rt Hon Michael Jack  
Chairman**

**John Whiting  
Tax Director**

Office of Tax Simplification  
1 Horse Guards Road, Room G41  
London SW1A 2HQ

Tel: 020 7270 6190

11 July 2014

**David Gauke MP  
Exchequer Secretary to HM Treasury**

Dear David,

We recently updated you about the new projects the OTS is seeking to undertake this year, and have since been developing the Terms of Reference for projects on employment status and tax penalties.

We have already discussed and agreed the Terms of Reference for both of these projects with the OTS Board, and with the relevant HMT and HMRC teams.

Please see below the terms for each project.

This letter is to ask whether you agree with the terms set out for both projects. If so, we intend to publish them on our website and formally announce the new projects.

We would be grateful for your response by the end of next week.

Yours sincerely,



Rt Hon Michael Jack



John Whiting

## **Employment Status Project – Terms of Reference**

### **Background**

The boundary between employment and self-employment has not kept pace with changing work patterns, especially in recent years. Many people work for more than one business and can be classed as employed for one job and self-employed for other work. The growth of freelancing as a way of conducting business had led some to suggest this is a ‘third way’ between employment and self employment.

There are significant tax and NIC differences between employed and self employed status. Getting the status wrong in a working arrangement can be very costly for the business in particular and often for the individual. These potential tax and NIC benefits and risks drive business behaviour, exemplified by many of the personal service companies that are in use (though many are simply sensible vehicles for the taxpayer’s operations).

### **Previous OTS work**

The distinction between the employed and self-employed was highlighted as a major fault line and source of complexity in the OTS reliefs review and the small business review. The first stage of the latter review reported specifically on IR 35 with recommendations for improving its operation.

The OTS noted that it is important for the tax system to fit with the real world but in many instances case law is complex and difficult to apply, for large and small businesses alike. Offering more certainty to individuals and businesses would be a useful simplification.

### **The OTS employment status project**

The Government has therefore commissioned the Office of Tax Simplification to examine the dividing line between employment and self-employment and whether it is drawn in the right place and in the right way. In carrying out their work the OTS will consider:

- Whether the UK’s current employment status tests result in real uncertainty and if so, for what sections of the workforce and in which areas.
- Sectors and types of engagement with the labour market where difficulties in administering the tax rules are relatively common for any or all of those involved with the tax system.
- How well current rules and guidelines fit with situations where individuals have multiple roles; whether the key distinction is between working and not working.
- Trends in employment law.
- HMRC guidance and advice.

- The special cases regulations, primarily as evidence of existing difficulties with the main tax rules.
- The scope for simplification through the increased use of digitisation.
- International comparisons to the UK approach to dealing with employment status and the experience of other countries in managing their approach.

The review will **not** consider:

- IR 35: previous OTS work has made recommendations in this area and the government decided how to take the issues forward. The recent report of the House of Lords Economic Affairs sub-committee has also examined the area.
- The Construction Industry Scheme: CIS has overtones of employed/self employed issues but is not directly relevant the OTS project; HMRC are also currently consulting on proposals for improving CIS.
- The expenses rules for employed and self employed people.

The review should have regard to:

- The impact on employers and employees of any changes;
- The cost/benefit to the Exchequer;
- HMRC operational impacts;
- Interaction with employment law, including EU aspects;
- The on-going project on PAYE/NIC operational integration;
- Fairness and consistency of treatment of taxpayers; and
- The need for anti avoidance measures.

The Office has been asked to produce a report in time for Budget 2015. The intention is that this report will contain any appropriate 'quick wins' that it may be possible to take forward quickly. However, it is likely that if the report points the way to significant reforms, these would be for the next government to consider.

The Office's work will be informed by consultation with interested parties, including forming and working with a consultative committee.

## Tax Penalties Project – Terms of Reference

### Background

It is important that civil penalties for non-compliance are proportionate and deter initial and future non-compliance. It is also important that penalties are well known, easy to understand, consistently applied across taxes, taxpayers and offences and are seen as fair by affected taxpayers.

Penalties are governed by various Acts from the Stamp Act 1891 to recent Finance Acts 2007 to 2012. The more recent penalties, from FA 2007 onwards, are mainly behavioural based with the aim of driving compliant behaviour.

### Previous OTS work

The OTS published a paper on thresholds within tax legislation in October 2012. This paper identified 204 numerical penalties relating to HMRC penalties and other administrative powers. It is clear that the *Review of HMRC's Powers, Deterrents and Safeguards* from 2005 to 2012, whilst providing considerable modernisation and rationalisation of penalties and powers across the merged HM Customs and Excise and Inland Revenue, did not wholly complete the process. The Review concluded that as far as the remaining areas were concerned, the benefits 'did not justify wholesale reform, and that changes should be made as and when opportunities arose.' No changes were considered pressing enough to include in Finance Bills 2013 or 2014.

The OTS has noted in other projects – notably that on Partnerships – that some penalties are seen as not operating fairly. Questions have also been raised with the OTS that some penalties are not always achieving the behavioural change that is intended.

The Government has therefore commissioned the Office of Tax Simplification to carry out an initial project to examine whether penalties could be simplified, made more consistent and more effective in successfully driving compliant behaviour. In carrying out their work the OTS will have regard to:

- Areas of particular difficulty for businesses and individual taxpayers and areas where HMRC find difficulties in administering the penalty rules;
- HMRC guidance and advice;
- Examination of the number and range of HMRC financial penalties issued to consider if they are proportional and have been targeted correctly;
- Examination of the number and range of financial penalties issued to consider if they have been successful in deterring non-compliance and generally influencing behaviours in the ways intended;

- Consideration whether the total number of different penalties could be reduced;
- Consideration if there is a need for revalorisation of penalties and on what basis;
- Consideration if there is another way to drive compliant behaviour that is more effective, cheaper and better targeted.

The review will concentrate on civil penalties, including the operation of suspension, reasonable excuse and special reduction. The review will not consider:

- Non-financial penalties such as imprisonment;
- Other HMRC administrative powers such as 'discovery' to assess whether these powers are working as intended (i.e. enquiry periods).

The review should have regard to:

- Fairness and consistency of treatment of taxpayers;
- The impact on taxpayers of any changes;
- The cost/benefit to the Exchequer;
- HMRC operational impacts;
- International experience;
- The experience of other UK authorities with penalty and information powers (i.e. the FSA); and
- EU and HRA law.

The Office has been asked to produce a report in time for Budget 2015. The intention is that this report will contain any appropriate 'quick wins' that it may be possible to take forward quickly. However, it is likely that if the report points the way to significant reforms, these would be for the next government to consider and would probably entail further OTS work.

The Office's work will be informed by consultation with interested parties.