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FCSA Response to:

Independent Review of Employment Practices in the Modern Economy

17 May 2017

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Background to FCSA

The Freelancer& Contractor Services Association (FCSA) is the largest independent trade association for professional employment services, with members providing umbrella, accountancy and business support services to the flexible workforce. At the time of writing the FCSA has 15 Accredited Members and 56 Associate Members who collectively represent *over 120,000 self-employed professional contractors*.

Set up in 2008, FCSA are industry leaders with credibility and a proven track record. Our purpose is to set the standard in the marketplace by ensuring that our Accredited Members and Associates fulfil their financial, tax and legal obligations. We have a Charter that sets out the minimum standards that we expect from all of our members.

Our role in self-regulation

Accredited Members voluntarily have their business operations independently tested every year to confirm adherence with the FCSA Code of Compliance, published on the FCSA website. The code standards are the most stringent and comprehensive in the industry. It includes sections on: governance, corporate structure and financial stability checks, relationship with recruitment businesses, relationships with contractors, umbrella employment operations, accountancy support operations, self-employment operations and the Construction Industry Scheme. Importantly, no FCSA Accredited Member is allowed to operate Offshore Schemes, Loan Schemes, Trusts, Managed Services Companies Schemes, Pay-day-by-Pay models, or similar.

Any contractor, agency, or end-hirer choosing to work with an FCSA accredited member is assured that the member operates at the highest industry standards for the benefit and protection of the contractor/agency/end-hirer. Compliance is important to FCSA, and through our annual testing of members, FCSA accreditation reduces risks and increases value to the supply chain.

Working with government

In our role as the trade association for umbrellas firms and specialist accountants that support contractors, we represent our members' views to government with the aim of advising on potential complexities of proposed changes and avoiding any unintended consequences. FCSA has worked closely with HMRC, HMT, OTS and BEIS (BIS) in recent years in providing evidence and contributions to their various policy initiatives that have impacted on the financial elements of self-employment. Numerous recent tax policy changes have penalised the contingent workforce, leaving them financially worse off and under-valued by a Government that says it recognises the economic importance of the flexible workforce. It would be wrong to further penalise the workers and the businesses that have been the financial backbone of the UK in recent years.

Executive Summary

FCSA supports this review of modern employment practices and we welcome the opportunity to contribute. In addition, Julia Kermode participated in giving evidence at the session in Coventry on 23 March 2017. Current policy direction implies that permanent employment is preferable to other ways of working which contradicts the current labour market and the informed choices made by many people. We believe this is the wrong direction to take, and we urge this review to conclude in favour of supporting the diverse contingent workforce, which is chosen by up to 24% of all working people.

In our response to this review we focus on the following terms of reference:

- New business models / modern employment practices of umbrella and self-employment
- The balance of rights and responsibilities
- Security, pay and rights of umbrella employment and self-employment
    - the different entitlements open to people being engaged in these ways
    - evidence of the different appetites for additional security / rights for self-employed depending on their business model

The evidence we highlight originates from FCSA's detailed research and analysis undertaken in May 2017, and it provides essential insights regarding the appetites for additional benefits. It is clear that there are vastly different needs and that a wholesale approach to making changes is the wrong approach. Instead changes should either be optional or segmented to target the populations that actually want them.

We also highlight the importance of both umbrella employment and personal service companies as modern employment practices that should be encouraged by government because they support the crucial flexibility of the workforce that is necessary for the UK economy.

There have been a number of cases recently highlighted in the media that suggest those working in so-called precarious roles are not doing so by choice and are potentially exploited. Whilst this may be the case in some instances it is certainly not true of everyone within this "precarious" definition. Many of the issues are not related to the status and rights of different types of workers, but the *employment practices* of the businesses that are engaging them. Poor practice and exploitation should never be tolerated, but neither should the actions of a minority result in disproportionate attention that could have unintended consequences for the majority.

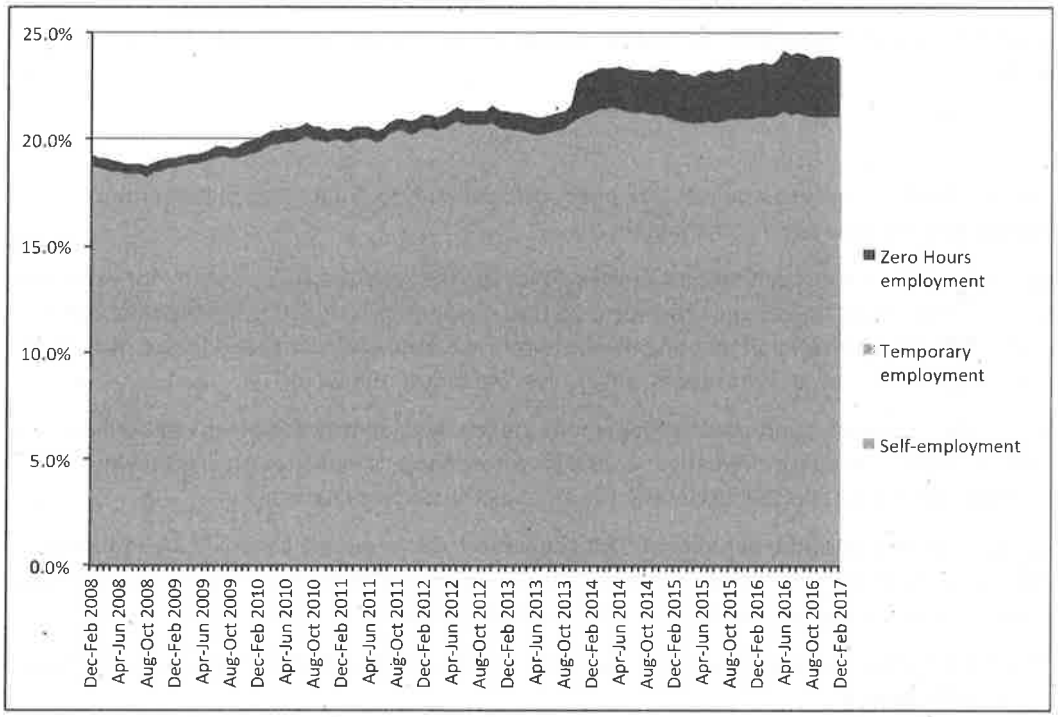
Individuals who have not specifically chosen their employment status should be the priority in terms of NMW and employment protections, for example low skilled workers, "casual" sectors, and those exposed to great degrees of control in the manner and way they perform their work. These groups are more susceptible to exploitation and are not the same as independent knowledge-workers, consultants, skilled engineers, technicians, broadcasters etc. Workers engaged to deliver skills not permanently retained within the end-hirer's business have more power to negotiate, they do not need nor want employment rights from the engagement and are more difficult to exploit by the end-hirers.

Self-employment and other atypical ways of working are not new in the labour market; growth of non-permanent working began in the early 2000s and the increase has taken place in line with the increase

in overall employment within the UK. The ability of the UK labour market to respond to economic change has been a significant asset in recent years, particularly in response to the 2008 financial crisis, following which the contingent workforce has been widely acknowledged as driving economic recovery to date.

Comparing 2008 to today, as a percentage of the whole workforce, contingent labour has increased by 4.5 percentage points (from 19.3% to 23.8%). The drivers of that growth have been zero hours contract employment (shifting from 0.5% to 2.8% of the UK workforce) and self-employment (moving from 13% to 15%).

Figure 1: The proportions of the UK workforce that are self-employed, temporarily employed or engaged on a permanent employment contract on zero hours in their main job, Dec-Feb 2008 – 17



In responding to repeated consultations the FCSA and other stakeholders have recommended an approach that segments the population and allows HMRC to target identified abuse by provider type, industry sector job type, worker responsibilities, degrees of control and or wage rate. Stop blatant abusive behaviours by enforcement of existing legislation.

We consider the problem in doing this to be more one of unacceptable *politics* rather than being a hard to determine *policy*. This conflict of politics and policy needs to be addressed before substantive progress can be made. HMRC's attempted solutions have not: been proportionate and do not focus on the real abuses in the system, they do not recognise the nuances of the self-employed population. Employment status is complex and we are increasingly concerned that Government policy is evolving towards permanent employment being the best solution, driven by the inability to develop adequate policies to deal appropriately with the abuses that we repeatedly report to HMRC and others.

Recommendations:

FCSA exists to raise standards and promote compliance, and through our accreditation we encourage self-regulation in our sector of supporting contractors to meet their tax and legal obligations. We make several recommendations at the end of each report section which we have listed here in the order in which they are discussed.

Umbrella

1. Encourage umbrella as a modern employment practice because it denotes full statutory rights and employment benefits whilst giving contractors flexibility to undertake numerous assignments. It is also an important tax collector for the Exchequer.
2. Support self-regulation activities of bodies such as FCSA
3. Consider licencing of umbrella firms, and/or take action against dubious models that are not umbrella.

Strategy development

4. Resolve the conflicts between politics and policy and use that to create a viable roadmap acceptable and recognised by stakeholders
5. Design and publish a strategy that harmonises policy, politics and the UK's strategy for economic prosperity. This needs to prevent short term tactical changes introduced by HMRC that are disrupting the supply chain and creating movement of workers backwards and forwards between different engagement models based on what is the "flavour of the week".
6. Recognise the evolution of different engagement models and identify the drivers behind each for end-hirers, workers and intermediaries. Establish where there is exploitation and tackle accordingly. Do not be tempted to let the tax tail wag the commercial dog.
7. Encourage and recognise the benefits of "self-regulation" in the supply chain. FCSA and others are fully supportive of high standards of compliance, worker protection and the removal of false self-employment, as well as the removal of false-employment.
8. Identify the different vulnerabilities (and exploiters) of the flexible workforce and protect those who need AND want it.
9. Once the commercial roadmap exists then, in conjunction with the Office for Tax Simplification (OTS) determine the best way to level the playing field where workers and employers pay differing amounts of taxation depending upon the method by which the worker is engaged. If this is done as a long term proposal then market rates will adjust to reflect the differing values end-hirers attach to work in the gig economy.

Clarify definitions

10. Align the legal and fiscal definitions of "worker" and "employment status" so that the legislation does not leave issues such as employment status to the Courts (or HMRC).
11. Do not roll out HMRC's Employment Status Service without significant revisions because, despite the misleading name, it only assesses IR35 status which is different to employment status.

Enforcement

12. Promote awareness of, and enforce current rules around transparency of pay

13. Increased compliance activity based on existing legislation
    Current legislation is sufficient to deal with bad practice if properly enforced. A more proactive stance by HMRC to publish their position on bad practice would remove the high ground that proponents of certain schemes believe they occupy. We are frustrated that HMRC do not appear to proactively challenge poor practice, nor publish their enforcement activities, therefore giving the illusion that scheme promoters might never get caught.

    We understand that specific cases are confidential which restricts what can be published, however HMRC could do more to support compliance. We also understand the resource constraints of HMRC, however if more funds were invested into policing compliance then the returns would be two-fold: more income for the Exchequer, and greater awareness of enforcement activity.

14. Introduce rules requiring end-hirers to verify that their supply chain is compliant with employment regulations
    A more proactive stance could be taken to ensure that end-hirers are aware of the workforce practices taking place throughout their supply chain. Hirers could be required to produce an annual statement confirming the steps they have taken to verify that their supply chain is compliant, and that their whole workforce (permanent and contingent workers) is not being exploited. There is precedent for such an approach through the Modern Slavery Act, but the annual statements required here do not go far enough.

15. Develop the remit of the Director of Labour Market Enforcement
    The remit of the newly appointed Director of Labour Market Enforcement could be expanded to encompass aspects of poor practice outlined in this evidence paper. Presumably there are resource constraints for this new directorate, meaning they will focus on the most exploitative practices within the labour market initially, such as modern slavery, so the self-employed and umbrella sectors are unlikely to be an initial priority. We hope that as the role of the directorate expands in the fullness of time, there will be some activity to support compliance within our sector.

Tax considerations

16. **Do NOT roll out IR35 changes to the private sector** as such a move would be disastrous, adversely impacting on business agility, workforce flexibility, UK competitiveness and it taxes people as employees but without any of the accompanying security or rights.

17. Retain current differentials in taxation for employees and true self-employed people as the latter is a business with associated costs, risks and liabilities.

18. If taxation for different employment statuses is to be reviewed, ensure that the self-employed security, rights and benefits are reviewed alongside this. Make any additional benefits (that presumably are provided in exchange for moves to more equalised tax) optional, or take a segmented approach dependent on business structure type given the differing wants, needs and views of sole-traders vs personal service company directors evidenced in this report.

NICs considerations

19. If NICs for different employment statuses is to be reviewed, ensure that the self-employed security, rights and benefits are reviewed alongside this. Make any additional benefits (that presumably are provided in exchange for moves to equalise NICs) optional, or take a segmented approach dependent on business structure type given the evidence of differing wants, needs and views of sole-traders vs personal service company directors.

20. Remove the Minimum Income Floor for Universal Credit for self-employed people; this policy change is flawed, unfair (penalising at least 50% of self-employed as evidenced in this report) and unnecessary.

Payroll tax?

21. Do not introduce a payroll tax: it will render many public services unaffordable and will lead to an increase in offshoring and/or an acceleration of automation.

Pace of change

22. Undertake a considered review of the effectiveness of recent legislation impacting the contingent workforce

23. Do not introduce any further legislation without having first learnt lessons from other recent changes, including but not limited to: IR35 changes, tax relief on travel and subsistence expenses, salary sacrifice changes, onshore intermediaries, removal of flat rate VAT.

Modern employment practice 1 - umbrella

Introduction

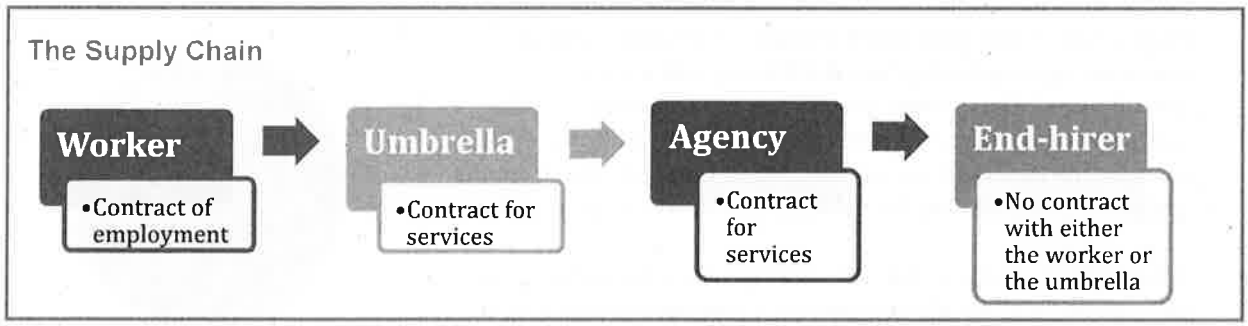
Given that umbrella firms enable contractors to carry out their assignments without also needing to become skilled financial specialists to run their own affairs, this arrangement safeguards the crucial flexibility of the workforce that is required within the modern economy, whilst also providing flexible workers with the broad range statutory rights and responsibilities to which they are entitled. Contractors working for an umbrella firm are by definition employed by that umbrella firm, and therefore have access to all statutory rights and benefits of employment. This includes annual leave, maternity, paternity, sick pay and pension contributions, and all of these rights are provided for by the umbrella firm.

With such arrangements being particularly effective for contractors in crucial sectors such as education, construction, IT and Health and Social Care, compliant Umbrella firms should be championed as a modern employment practice by government.

Umbrella employment is more stable than other more precarious forms of work, and at the end of this chapter we detail evidence of the current profile of umbrella employment to demonstrate this fact. We have compared data from our analysis 2 years ago and today, and there has been a definite shift towards higher earnings, increased length of assignments and increased length of employment at umbrella firms.

What is an umbrella company?

An umbrella company is an employer of contractors and freelance professionals who complete numerous different assignments at various locations for recruitment agencies and/or end hirers. There is an over-arching contract of employment between the umbrella and the employee, and this provides a portable package of employment rights enabling the employee to receive those same rights and benefits whilst working for various end-hirers. The supply chain is shown below:



In essence, umbrella is a mechanism that enables someone to be permanently employed whilst having the flexibility of being a contractor undertaking numerous short-term assignments. The overarching contract of employment guarantees an annual minimum number of hours to the employee, it is permanent employment which confers all 84 statutory rights and benefits received by UK employees.

Key benefits of umbrella employment to the worker

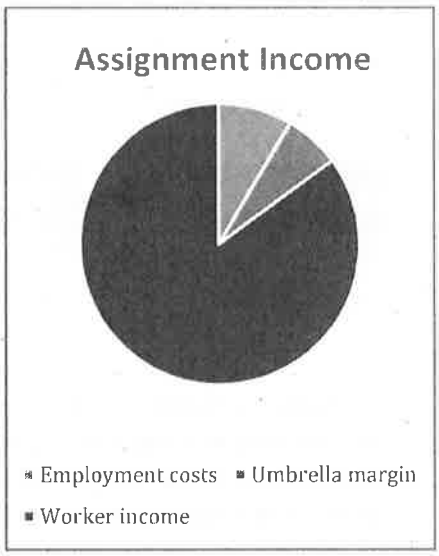
- Employment rights, including all statutory rights and benefits such as holiday pay, maternity, paternity, sick leave, pension etc.
- Employment history whilst working on a contingent, multi-location basis (notably to support access to finance, housing/mortgages, etc.)
- Joined up pay from fragmented working:
  - Many undertake multiple assignments during a week or a month
  - Umbrellas consolidate their workers earnings and ensure appropriate taxes are paid
- Peace of mind that tax is paid appropriately, with no need to submit an annual self-assessment return to HMRC
- Employee/HR support, in the unlikely event that an individual needs HR advice, such as a grievance case, as their employer the umbrella firm will have processes to support them
- Ability to claim tax deductible travel and subsistence expenses subject to status

Key benefits of umbrella employment to the agency or end-hirer
A fully compliant umbrella employer manages the commercial, employment, taxation, and statutory risks associated with the use of temporary workers for the supply chain. This minimises the overheads, employment risk and administrative burden of managing temporary workers in-house.

The alternative would be to process a significant amount of paperwork every time an individual wishes to be redeployed to a different role, agency or hirer. In a fast-paced project-driven environment where workers frequently change assignments, the resulting red tape of treating each change as a new employment would quickly become unmanageable.

How pay is calculated
The umbrella firm receives assignment income paid by the agency for the work undertaken. Like any employer, the umbrella must cover employment costs which includes employers' national insurance, apprenticeship levy, holiday pay and pension contributions. These employment costs are deducted from the assignment income. Umbrellas also retain a margin to cover their costs for the services they provide. This is also deducted from the assignment income, and the balance is the workers' gross pay.

The employment costs that umbrellas incur are the same as would be incurred by either the recruitment agency or the end-hirer if the individual were to be paid via either of those payrolls. The difference is that the umbrella recharges these costs back to the supply chain, which is where they would normally be paid if there was no umbrella in the mix.



It is illegal to deduct employers national insurance from a worker's pay, so it is essential that there is clarity regarding the difference between the assignment rate paid to the umbrella, and the worker's gross taxable pay. The assignment rate includes all employment costs, and the umbrella's margin, which once deducted leaves the gross taxable pay for the worker.

Umbrella firms as tax collectors

An umbrella firm, by definition, pays their employees via RTI payroll which ensures that all taxes and national insurance is paid. In this regard, they undertake the following on behalf of the supply chain:

- Collect and manage personal data in order to run payroll
- Pay apprenticeship levy
- Pay pensions contributions
- Deduct PAYE from gross pay
- Report via RTI
- Pay HMRC
- Report employee expenses and benefits
- Issue P45s, P60s and P11ds

If umbrella firms were not in the supply chain, all of the above administration would need to be carried out by either the end-hirer or the recruitment agency. In some sectors workers change their assignments frequently (because they have the flexibility to do so) and in such instances the umbrella provides continuity of employment as well as consolidated pay. Also, if the contractor stays with the same umbrella then it avoids all of the above processes being necessary for each and every assignment being undertaken. This is particularly beneficial in sectors which require numerous short-term positions, potentially at a different end-client every day of the week, such as supply teaching.

Due to their payroll function, umbrellas are an extremely efficient means of tax collection for the Exchequer. In 2015, we calculated the following:

- Total annual PAYE and NI paid the Exchequer via umbrella firms is £2.1 - £2.8bn
- This is an under-estimate and assumes that each umbrella firm is responsible for an average of 2,000 contractors in 2015
- Whereas the average umbrella company in 2017 is payrolling c3,300 contractors

> *"Umbrella companies have been part of the UK labour market for many years and, where operated responsibly, provide a useful conduit through which payments, including taxes, can be made. As such, Her Majesty's Revenue and Customs (HMRC) are not taking steps to stop agencies using umbrella companies to manage their payroll function"*
>
> *David Gauke, Financial Secretary to the Treasury*
> *In answer to written question 222349 asked on 27 January 2015*

Profile of umbrella employees

Umbrella employees increasingly work at the **higher, more stable end of the skills spectrum** in a diverse range of occupations:

- The proportion of construction workers within the Umbrella workforce has significantly diminished since 2015.
- Umbrella employment has increased in popularity within health & social care since 2015, predominantly as a means of providing overarching employment to fragmented working.

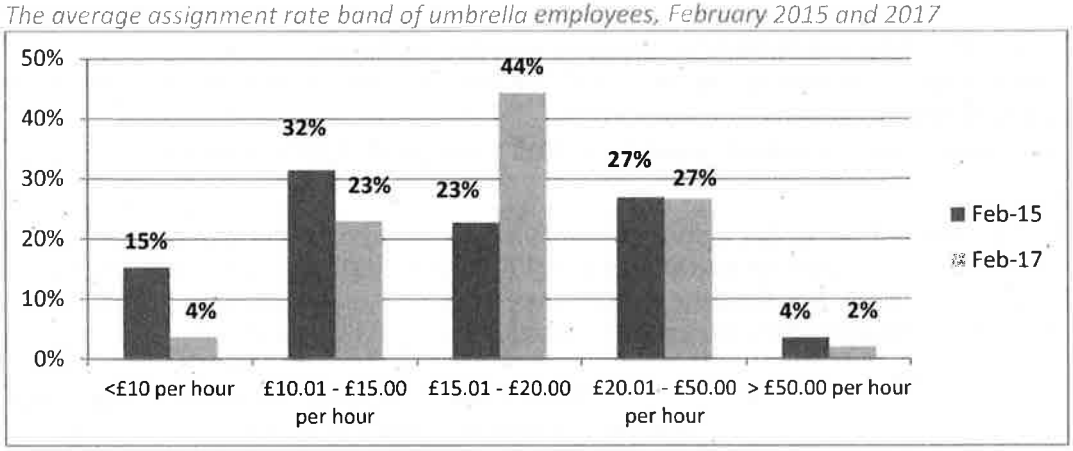
The proportional share of umbrella employees, by major occupational group, February 2015 & 2017

Occupation	% umbrella employees: 2015 (sample = 85,000)	% umbrella employees: 2017 (sample = 62,000)
White collar professionals (commercial, banking, finance, accountancy, education, legal, sales)	40%	38%
Construction	21%	7%
IT and telecoms	12%	10%
Transport & logistics	10%	7%
Engineering	7%	14%
Health & social care	6%	17%
Industrial / blue collar / utilities	2%	2%
Other	2%	5%

Source: FCSA Umbrella Employment Survey, April 2017

The average assignment rate of umbrella workers has risen significantly over the last two years. **Three quarters (73%) have an assignment rate above £15 per hour** (up from 53% in Feb 2015).

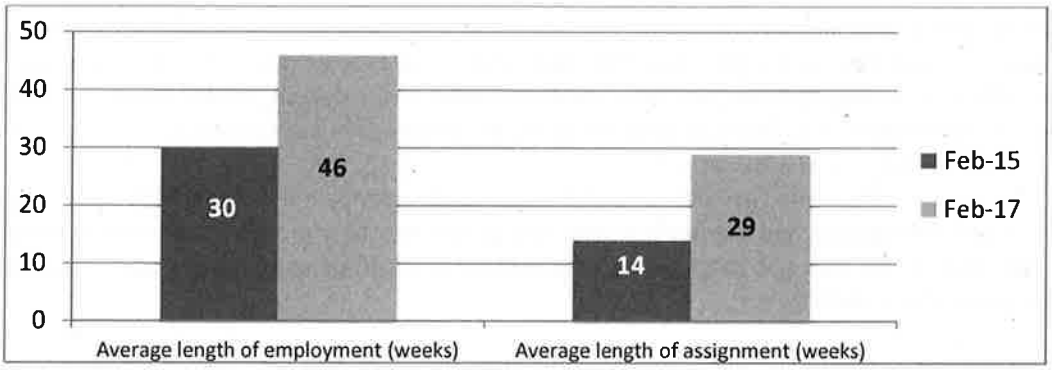
The average assignment rate band of umbrella employees, February 2015 and 2017



Source: FCSA Umbrella Employment Survey, April 2017

The average length of employment has **increased by over 50%** since February 2015, whilst the average **length of assignment has doubled** in the same period:

The average length (weeks) of employment and assignment, February 2015 and 2017



Source: FCSA Umbrella Employment Survey, April 2017

Umbrella employment is more stable than other more precarious forms of work, and is a modern employment practice that should be encouraged. The average length of contract assignments for an umbrella employee is 7 months (29 weeks), compared with 3 months (14 weeks) just 2 years ago. Most contractors stay with their umbrella firm for almost 1 year (46 weeks), 53% longer than the average (30 weeks) two years ago. Both of these factors clearly illustrate that umbrella provides more stability than temporary employment and/or zero hour contracts. An umbrella firm very rarely terminates someone's employment, the turnover of contractors is almost entirely led by the decisions of individual contractors – they either move to another umbrella firm or choose to work independently for themselves.

There are some dubious practices that take place driven by unscrupulous intermediaries that are **not umbrella,** and it is important to recognise the differences to avoid misunderstandings. We have prepared a summary of such practices in Appendix 1.

Recommendations

1. Encourage umbrella as a modern employment practice as it denotes full statutory rights and employment benefits whilst giving contractors flexibility to undertake numerous assignments. It is also an impottant tax collector for the Exchequer.
2. Support self-regulation activities of bodies such as FCSA
3. Consider licencing of umbrella firms, and/or take action against the dubious models that are not umbrella listed in Appendix 1.

Modern Employment Practice 2 – self-employment

Introduction

There are two main categories of self-employment; those that work for themselves as sole-traders or limited partnerships, and those that incorporate to a company structure and provide their services via that. Such corporate structures are often known as personal service companies because they are based around a knowledge worker providing their (personal) services to an end-hirer who is seeking particular skills on a contingent basis. We have conducted extensive research and our analysis of 898 responses (see appendices 2, 3, and 4) indicates that those operating through personal service companies are less inclined to want or need a minimum floor of rights / benefits compared to those who are sole-traders. Therefore, we recommend that any such introduction of benefits for self-employed people be optional, and segmented according to their business model. There also needs to be thorough consultation with self-employed people in order to ascertain exactly what rights, benefits and security might be provided.

Any such package of rights should be flexible to reflect different needs and preferences of varied segments of the workforce. A good example of such an approach is Uber's partnership with IPSE which guarantees their workers sick pay and injury cover, jury service cover of up to £2,000 and access to free advice and support on paying tax as well as personal finance issues.

Drivers of Increased Self-employment and growth in flexible working.

It is important to recognise that the 4.78m people that are self-employed encompass a very diverse range of occupations across all sectors, including consultants, interims, freelancers, entrepreneurs, locums, shopkeepers, tradespersons etc. It follows that the earnings of this group is also very diverse depending on the role being undertaken, and that policy changes intended to tackle one particular group is likely to have unintended consequences across a wide variety of professions and sectors.

We recognise the individual's need for flexibility of engagement. This flexibility relates to hours, geographical location and the corporate environment, including for some an aversion to close control and micromanagement. A significant proportion of workers want to be self-employed for these reasons alone.

According to research[1] undertaken by BIS in 2016, the majority of over 2,500 respondents consider their self-employment as a positive choice compared with being an employee. The benefits reported most often were having flexibility, independence, and job satisfaction. The report notes that less than 1% of self-employed cite tax as a motivation, and in fact a third believe they are financially worse off as self-employed. Despite this, most of these people appear to have made a conscious choice to prioritise other factors with 74% of them saying their life was better overall.

Notwithstanding, there can be financial advantages of being self-employed if some end-hirers reward them more highly compared to employees in recognition of the individual not having employment rights which also reduces the statutory burden on the end-hirer

[1] Understanding Self-Employment, BIS (2016)

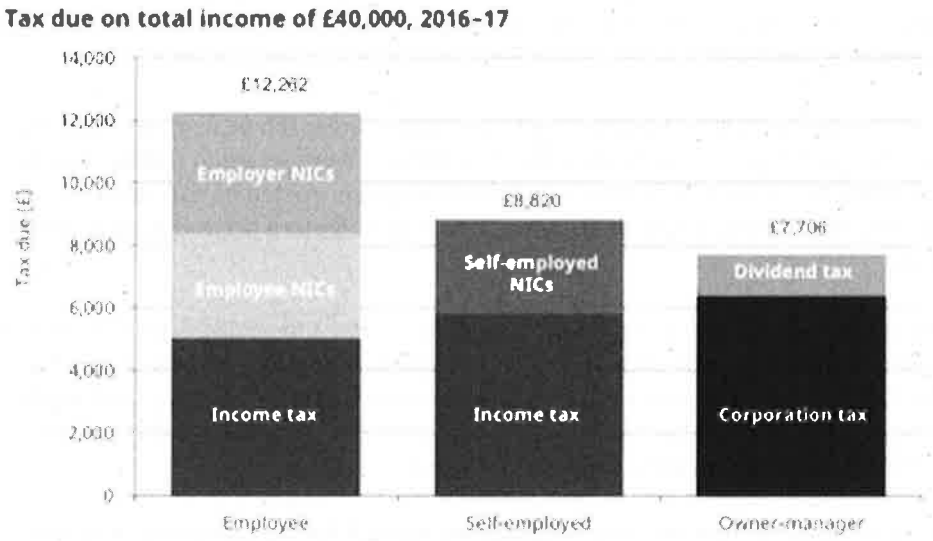
As an alternative to being self-employed as a sole-trader or a partnership, a large number decide to incorporate their business as a limited company. In recent years there has been some negative perceptions of such personal service companies (PSCs), proliferated by some media outlets that believe PSCs to be entirely about tax avoidance. However this is simply not borne out by the reality; the vast majority of decisions to incorporate are either:

- to meet the requirements of end-hirers (as many businesses choose not to engage sole traders due to their tax risk if not genuinely self-employed)
- or to limit the individual's liability so that their business assets are separated from their personal assets.

In addition to liability protection, personal service companies offer professional credibility, which can be a motivation for some individuals to incorporate.

It is important to note that PSCs are required to pay tax on their income, some of which might be drawn as salary and therefore subject to PAYE and NICs, plus other tax payable is in the form of dividend tax and corporation tax.

The Institute for Fiscal Studies 2017 Green Budget included an illustration of the different taxes due on £40k income if earnt by different forms of engagement:



Source: Figure 7.2 of the Green Budget. Notes: Income tax is slightly higher for the self-employed than for employees because the latter are charged income tax on income net of Employer NICs

The owner-manager category shown in the RHS column is what we refer to as a personal service company. The graph illustrates that the tax differential between PSC and sole trader is perhaps not as significant as it is perceived to be.

By being in business on their own account both sole traders and PSC directors are exposed to financial risk, loss of employment rights and protections are the disadvantages. In addition, personal service companies are subject to corporate law and the directors have certain legal obligations to fulfil. It is wholly wrong for anyone to be forced into having their personal service company without a full understanding of the inherent responsibilities, however we are aware that such exploitation does take place in a minority of cases.

Drivers for the End-hirer

New digital platforms have emerged that are fuelling the "gig economy". The matching of end-hirers seeking workers via online applications reduces traditional business costs rather than just tax costs, in many areas. These savings for business platforms such as Uber and Deliveroo are not isolated nor insignificant and should fall within the UK Corporation tax net.

As widely commented on by various think tanks and MPs, labour cost savings arising from self-employment may have an employer's National Insurance tax consequence if they relate to remuneration under certain models. In which case, one would expect there to be a noticeable decline in National Insurance Contributions received by the Exchequer, however recent evidence from the recent OBR Economic and Fiscal Outlook does not support this assertion. Their data shows that National Insurance accounted for 17.5% of overall tax revenue in 2010-11, and they predict will be the same proportion in 2016-170. If the increase in self-employment during the same period had negatively impacted national insurance contributions we would expect to see the proportion of tax revenue decrease from this source, but there has been no change and NICs are forecast to remain at the same proportion for 2021-22.

The CBI presented evidence[2] to the Treasury Select Committee earlier this year which challenged the assumption that the majority of corporations with no employees were set up to reduce their tax liabilities. They stated that 64% of corporations with no employees existed 6 years ago when corporation tax was 28% and there was no dividend allowance, therefore there was no tax motivation for incorporation.

Employers have a duty to shareholders to deliver stakeholder value and should not be accused of being too efficient if one engagement model is more suitable than another. We agree that the taxation system has failed to keep pace with changes in pension legislation, employment rights, digital platforms. In adopting more advantageous commercial models of engagement end-hirers are triggering tax effects often without them being the key driver.

End-hirers also seek flexibility from the fixed employment costs of having a permanent workforce. A business needs to be able to contract and expand to rapid and often unpredictable changes in the demands of the market place.

[2] Written evidence submitted by CBI to Treasury Select Committee's inquiry into UK tax policy and the tax base – further evidence on aspects of the shrinking direct tax base

End-hirers who can dominate fee negotiations with workers may also be able to pay self-employed workers less than it would cost to engage a permanent employee with associated costs of providing all 84 statutory benefits and rights, as well as employers national insurance contributions. They would also be saving incremental costs of employment rights such as holiday and sick pay.

End-hirers are also keen to export the administration burden and costs of compliance to intermediaries in the supply chain. One of the most significant elements of cost which they seek to avoid is the frequent revisions necessary to comply with process changes to RTI and other regular piecemeal interventions by HMRC, especially in an environment where HMRC themselves have to export all the burden of compliance and administration to the end-hirers in the face of their own internal budget cuts, e.g. recent changes to IR35 for off-payroll workers in the public sector.

Recommendations

4. Resolve the conflicts between politics and policy and use that to create a viable roadmap acceptable and recognised by stakeholders
5. Design and publish a strategy that harmonises policy, politics and the UK's strategy for economic prosperity. This needs to prevent short term tactical changes introduced by HMRC that are disrupting the supply chain and creating movement of workers backwards and forwards between different engagement models based on what is the "flavour of the week".
6. Recognise the evolution of different engagement models and identify the drivers behind each for end-hirers, workers and intermediaries. Establish where there is exploitation and tackle accordingly. Do not be tempted to let the tax tail wag the commercial dog.
7. Encourage and recognise the benefits of "self regulation" in the supply chain. FCSA and others are fully supportive of high standards of compliance, worker protection and the removal of false self-employment, as well as the removal of false-employment.
8. Identify the different vulnerabilities (and exploiters) of the flexible workforce and protect those who need AND want it.
9. Once the commercial roadmap exists, then in conjunction with the Office for Tax Simplification (OTS) determine the best way to level the playing field where workers and employers pay differing amounts of taxation depending upon the method by which the worker is engaged. If this is done as a long term proposal then market rates will adjust to reflect the differing values end-hirers attach to work in the gig economy.

Enforcement

Enforcement is an important element of supporting the modern employment practices of legitimate umbrella firms and personal service companies. However FCSA members continue to be extremely frustrated that current legislation does not seem to be adequately enforced, and yet if properly implemented could adequately deal with the abuses that we see taking place within our sector. Earlier this year we saw this inability to enforce existing legislation culminate in HMRC delegating IR35 enforcement to end-hirers or recruitment agencies (if there is one in the supply chain) for engagers of personal service companies within the public sector. The impact of this change has been significant, summary headlines are:

- End-hirers determining all of their self-employed contractors caught by IR35, meaning that all will have tax deducted from their income, not just the non-compliant ones (despite HMRC assurances that only non-compliant PSCs would be affected)
- There is no appeals process for those wrongly determined caught, so mechanism to be refunded the deductions incorrectly processed from their income
- Self-employed people paying tax as employees but without any of the accompanying 84 statutory rights or benefits
- Self-employed people financially worse off if they are unable to negotiate a higher assignment rate in order to account for the tax
- If assignment rates are increased due to the tax burden, this is funded by taxpayers by virtue of the policy being specific to the public sector. This additional cost will be borne at a time when public services are already significantly over-stretched
- Significant additional regulatory burden for end-hirers, both in terms of the IR35 determination and the payroll processes which are both complex, and this burden is usually delegated through the supply chain to recruitment agencies
- Self-employed people financially worse off due to the arbitrary removal of 5% business expenses allowance despite the personal service company now having significantly higher accountancy costs out of necessity in order to reconcile the taxed "employment income" alongside business income, business expenses, pension deductions etc. in order to ascertain the true financial position
- Highly skilled workers leaving the public sector in favour of the private sector (in the case of knowledge workers with transferable skills) or relocating outside the UK (e.g. health sector consultants), both of which will exacerbate skills shortages

All of the above could have been avoided if HMRC had simply enforced current legislation better. We are repeatedly told that increased compliance activities are impossible due to restrictions on HMRC's resources, however we are firmly of the view that a relatively minor investment in compliance activity would generate profits far in excess of the cost, this bringing more funds to the Exchequer as well as enhancing HMRC's reputation as enforcers of the law. All too often serial abusers believe they will not get caught, and HMRC's poor track record only serves to reinforce this perception.

Alongside the IR35 changes to the public sector HMRC developed an online tool, the Employment Status Service (ESS) designed to support end-hirers, contractors and recruitment agencies ascertain the IR35 status of a given assignment. The theory is sound, however the Employment Status Service is

fundamentally flawed because it ignores the judiciary and case law by virtue of disregarding mutuality of obligations, which is a basic pillar of ascertaining IR35 status. HMRC incorrectly believe that mutuality of obligations is present in all cases where the employment status service might be used, however we disagree because a number of IR35 status cases have hinged on the very question of mutuality of obligations and omitting it from the ESS is at best misguided, but at worse it is changing legislation which they guaranteed they would not be doing.

We are very concerned that the ESS will simply be rolled out more widely to be used to ascertain individuals' employment status, but we strongly recommend that this does not happen in its current form because employment status is **not the same** as IR35 status. This relates to the mismatch of employment status and tax statuses. It is possible to be genuinely self-employed but yet caught by IR35 and required to pay tax at a similar rate to that paid if they were an employee.

Other areas where enforcement is lacking include a number of dubious non-umbrella models (see appendix 1), national minimum wage and agency conduct regulations. For example, offshore loans and employee benefit trusts are still present in the market despite HMRC taking action intended to stop their usage. More positively, HMRC has recently taken quick action to issue a "spotlight" against a job board tax avoidance scheme which is a recent example of success enabling the market to stamp out a new non-compliant model.

As already outlined earlier, transparency of pay can be a significant issue for supply chains where an umbrella employs the worker because the additional costs of employment are not properly factored into the supply chain costs. There are pre-existing agency conduct regulations that govern required practices in relation to workers pay, however there does not seem to be enough awareness about these, nor are they properly enforced. Both of these factors lead to some firms cutting corners, resulting in workers being misled regarding their pay rate which is unacceptable.

A more proactive stance could be taken to ensure that end-hirers are aware of the workforce practices taking place throughout their supply chain. Hirers could be required to produce an annual statement confirming the steps they have taken to verify that their supply chain is compliant, and that their whole workforce (permanent and contingent workers) is not being exploited. There is precedent for such an approach through the modern slavery act, but the annual statements required here do not go far enough.

We are committed to compliance and for this reason we welcome the appointment of the Director of Labour Market Enforcement. We hope that once the role becomes established there will be some tangible progress in dealing with the abuses that we see taking place regularly. We are already actively engaged as stakeholders and have contributed to their strategy development process. We were due to meet Sir David Metcalf to discuss our concerns, but this has needed to be rescheduled due to purdah. We believe that the role has great potential and we support the improved compliance that will surely result.

To reiterate our fundamental point, we believe that it is imperative that proper enforcement of current legislation is prioritised as it will achieve significantly better results than developing yet more legislation. In terms of potential new regulations, what is actually required is a thorough and holistic consideration of the bigger picture before contemplating any further legislative change.

Recommendations

10. Do not roll out HMRC's Employment Status Service more widely without significant revisions because, despite the misleading name, it only assesses IR35 status which is different to employment status.

11. Align the legal and fiscal definitions of "worker" and "employment status" so that the legislation does not leave issues such as employment status to the Courts (or HMRC).

12. Promote awareness of, and enforce current rules around transparency of pay

13. Increased compliance activity based on existing legislation
    Current legislation is sufficient to deal with bad practice if properly enforced. A more proactive stance by HMRC to publish their position on bad practice would remove the high ground that proponents of certain schemes believe they occupy. We are frustrated that HMRC do not appear to proactively challenge poor practice, nor publish their enforcement activities, therefore giving the illusion that scheme promoters might never get caught.
    We understand that specific cases are confidential which restricts what can be published, however HMRC could do more to support compliance. We also understand the resource constraints of HMRC, however if more funds were invested into policing compliance then the returns would be two-fold; more income for the Exchequer, and greater awareness of enforcement activity.

14. Introduce rules requiring end-hirers to verify that their supply chain is compliant with employment regulations
    A more proactive stance could be taken to ensure that end-hirers are aware of the workforce practices taking place throughout their supply chain. Hirers could be required to produce an annual statement confirming the steps they have taken to verify that their supply chain is compliant, and that their whole workforce (permanent and contingent workers) is not being exploited. There is precedent for such an approach through the Modern Slavery Act, but the annual statements required here do not go far enough.

15. Develop the remit of the Director of Labour Market Enforcement
    The remit of the newly appointed Director of Labour Market Enforcement could be expanded to encompass aspects of poor practice outlined in this evidence paper. Presumably there are resource constraints for this new directorate, meaning they will focus on the most exploitative practices within the labour market initially, such as modern slavery, so the self-employed and umbrella sectors are unlikely to be an initial priority. We hope that as the role of the directorate expands in the fullness of time, there will be some activity to support compliance within our sector.

Tax considerations - security, pay and rights

This review into modern employment practices does not include terms of reference in relation to tax issues, however it does play a significant role in employment status and how individuals are engaged by end-hirers. This review is tasked with considering security, pay and rights of different employment practices, and tax necessarily plays an important role in these issues.

We have seen a number of different commentators, politicians and think tanks make tax related comments and/or recommendations in recent months and in this section we outline our views on these, along with accompanying evidence to support our position.

As already outlined in the previous section we have very significant concerns regarding the recent IR35 changes and we strongly urge the review panel not to recommend rolling out the changes to the private sector which we believe would be disastrous for the following macro reasons:

- It would adversely impact on the flexibility of the very workforce that has proven itself to be important for the UK's economic success, particularly during the recent downturn.
- The flexibility of the UK's highly skilled professionals, consultants and interims is acknowledged as important to the UK's competitiveness in the global marketplace[3]. If it becomes unattractive or difficult for businesses to engage the workforce they need from within the UK, they may choose to obtain talent from overseas (technological advances mean that roles can be conducted anywhere) or indeed relocate outside the UK.
- It taxes people as employees but without any accompanying security or statutory rights

There is a tax differential between employment and self-employment which we believe is appropriate and should be maintained. By being in business in their own right, self-employed people (whether sole-traders or incorporated companies) are subject to significantly more risk and precariousness than employees, and that risk should be rewarded. There are 84 statutory rights and benefits that are intrinsic to employment, however by comparison self-employed people have zero such rights or benefits.

Businesses currently have access to highly experienced and specialised knowledge based workers to fulfil short term consultancy needs at a fraction of the cost of engaging a large consultancy firm. It is this strategic value that interims and independent professionals are able bring to SMEs that is so important and such independent professionals often prove themselves an essential asset to the engaging business. Increasing the cost of this, or failing to encourage and incentivise the consultant to go it alone removes this option for businesses, hiring businesses, and therefore we believe that government should continue to nurture and incentivise self-employed people in all sectors – from tradespersons through to interim managers and specialist consultants. Current differences in taxation are appropriate and should be maintained.

[3] Neil Carberry, Director for People and Skills, CBI: '97% of firms believe that a flexible workforce is either vital or important to the competitiveness of the UK'

If the taxation rates change to equalise the amount paid by self-employed people to that of employees, they will rightfully challenge for similar protections from the state. These would include statutory sick pay, statutory holiday and statutory redundancy entitlements.

Due to the significant potential implications of such changes, FCSA has conducted extensive research[4] to ascertain the views of 898 self-employed people in relation to potential benefits. The resulting data is shown in full within Appendix 2, and the relevant figures are referenced within the text below.

More than **three-quarters (76%) of all self-employed have no provision** (figure 2.1) within their businesses to cover for the eventuality of being sick, being made redundant by a major client or affording to take a holiday. There is some variation by business type with more Ltd Co directors having provisions, and a higher degree of vulnerability amongst those aged 51-60 (figure 2.2).

Of those that do have fall-back arrangements in place (24%), **just one in five (19%) have any form of sick pay provision** (figures 2.3 and 2.4).

- Proportionally more PSC directors have sick pay cover (24%)
- Those aged 51-60 – across all forms of self-employment – are more exposed (just 12% have sick pay provisions).

The potential 'value' to the self-employed of **sick pay provision was rated higher** (figure 2.5) than for any other potential benefit or aspect of in-work support.

- On a 1 (low) to 10 (high) point scale, self-employed rated the value of sickness provision at 7.7
- Ltd Co directors rated its value lowest amongst any cohort (6.4).
- Women rated the value of sick pay provision the highest (8.8).

Just 16% of self-employed workers have such provisions in place to afford them to take a holiday

- Ltd Co directors are notably more likely to have such provision in place than their sole trader or Ltd Partnership counterparts. (figure 2.6)
- The proportion of all self-employed with holiday provision within their businesses diminishes with age through until the 51-60 year old age group, where just 11% have cover. Conversely, one quarter of those aged 61+ have this provision (figure 2.7)

Just one in seventeen (6%) self-employed workers has provision for the eventuality of a sudden loss of work through the requirement from their sole client / a major client becoming 'redundant'.

- Ltd Co directors are twice as likely as Sole Traders to have 'redundancy' provision. (figure 2.8)
- Self-employed in the age range 31-50 are seven times more likely than those aged 51+ to have 'redundancy' provision. (figure 2.9)

[4] Appendix 2

The potential 'value' to the self-employed of **some form of 'redundancy' entitlement** for the sudden loss of a sole or major client also raised interest (figure 2.10):

- On a 1 (low) to 10 (high) point scale, self-employed rated the value of sickness provision at 6.3.
- Once again, Ltd Co directors were the least interested in the provision (5.4) – notably lower than Sole traders (7.1) and Ltd Partnerships (7.2).
- Interest in the provision significantly diminished with age.

We note that there is also a differential in terms of national insurance contributions, which we also believe is appropriate because access to benefits funded by NICs is **not equal** which we will go on to discuss in the next section.

Recommendations

16. **Do NOT roll out IR35 changes to the private sector** as such a move would be distraous, adversely impacting on business agility, workforce flexibility, UK competitveness and it taxes people as employees but without any of the accompanying secruerity or rights.

17. Retain current differentials in taxation for employees and true self-employed people as the latter is a business with associated costs, risks and liabilities.

18. If taxation for different employment statuses is to be reviewed, ensure that the self-employed security, rights and benefits are reviewed alongside this. Make any additional benefits (that presumably are provided in exchange for moves to more equalised tax) optional, or take a segmented approach dependent on business structure type given the differing wants, needs and views of sole-traders vs personal service company directors evidenced in this report.

NICs considerations - security, pay and rights

A key argument supporting the equalisation of NICs often given by politicians and various think tanks is "now that everyone has access to the state pension, benefits funded by NICs are more or less equal so it follows that everyone should pay the same rate".

However:

1.1 pension entitlements are not equal
1.2 equalisation of maternity & paternity payments would not be equal
1.3 equalisation of NICs contributing towards the potential entitlement to Job Seeker's Allowance is a red herring as it is increasingly being replaced by Universal credit
1.4 minimum income floor for universal credit is not equal for SE

Due to the significant potential implications of equalising NICs, FCSA has conducted extensive research to ascertain the views of 898 self-employed people in relation to potential benefits. The resulting data is shown in full within Appendix 3, and the relevant figures are referenced within the text below.

1.1 Pension entitlements are not equal

Whilst it is true that the State Pension is now accessible by self-employed people, many will not qualify if they do not have 35 years NICs contributions. Our research conducted in May 2017[5] indicates:

- Less than one in five self-employed people (18%) know where they currently stand with regard to their contributions progress towards their State Pension. (figure 3.2)
- More than one third (35%) do not have any plans / arrangements to fund their retirement
  - Personal Service Company directors are least likely to have no plans (figure 3.3)
  - Just 12% of those aged 61+ have no plans for retirement (figure 3.4)

The self-employed are also missing out on the government's contribution to a secondary pension. But before the government rushes to 'level the playing field' on extending auto-enrolment to all self-employed, it should be fully aware of the current state of play amongst the self-employed in terms of making their own allowances for secondary pensions:

- 43% self-employed already have at least one secondary pension. (figure 3.5)
- PSC directors are significantly more likely to have secondary pensions than other self-employed businesses. (figure 3.6)
- 24% of all self-employed (27% of males and 19% of females) are contributing to a non-employer personal / private pension plan.

[5] Appendix 3

- 9% of all self-employed (11% of males and 6% of females) are contributing to an employer pension plan.
- 20% of all self-employed (19% of males and 21% of females) have a legacy employer pension that they are no longer making contributions into.

In terms of what type of pension plan these secondary arrangements are (figure 3.7):

- 21% of all self-employed with at least one secondary pension plan are contributing to an employer's pension plan,
- 46% (with at least 1 secondary plan) are contributing to a private / personal pension plan
- 21% (with at least 1 secondary plan) have a legacy employer's pension.
- Contributory employer pension plans are less prevalent amongst sole-traders / ltd partnerships

With 43% of all self-employed people having at least one secondary pension scheme, it is somewhat unsurprising to see that the perceived 'value' of a government initiated scheme of pension auto-enrolment is far lower than other potential support mechanisms that could be afforded to this workforce (figure 3.8):

- On a 10-point scale (1=low value and 10=high value), the perceived 'value' of auto-enrolment to the self-employed registered at **just 6.5**
    - significantly lower than the 'value' placed on financial support in times of sickness.
- Once again, PSC directors were the least interested in the provision (5.5) – notably lower than Sole traders (7.3) and Ltd Partnerships (8.0).
- There is more interest in the provision from women than men – which is unsurprising as women, as we have evidenced, are less likely to be contributing to a secondary pension.

In terms of the subsequent likelihood of the self-employed remaining opted in (if auto-enrolled) or opting out, **22% know that they would opt out and a further 28% are currently unsure whether they would remain in or opt out** (figure 3.9).

- The significant ambivalence of PSC directors to the potential of pension auto-enrolment translates into **one third (32%) knowing that would opt out and a further one third (32%) being uncertain** to as to whether they would remain in or opt out.
- For **Sole Traders and Ltd Partnerships**, however, **the known intent to opt out**, should the scheme be extended to them, are dramatically lower (just **14% and 8% respectively**).
- When looking at interest levels by age, **it is only those up to the age of 30 that have a notably below average level of combined certainty or potential that they would opt out** (32% versus the 50% all self-employed average). (figure 3.10)
- A combined 54% of males would opt out or are uncertain compared to 41% of females.

One additional reason why the potential opt in figure may be so low amongst the self-employed is that, in addition to having a raft of existing secondary pensions, **one quarter (25%) of self-employed people have made other plans for how they will fund their retirement beyond pensions**. This includes (figure 3.11):

- 22% of all self-employed (including 30% of Ltd Company directors) who are making other investments to fund retirement plans (property, ISAs, etc.).
- 3% of all self-employed (including 6% of Ltd Company workers) who intend to sell their business to fund their retirement.

1.2 Equalising maternity and paternity pay entitlements does not deliver equal value

National insurance contributions fund statutory maternity and paternity pay allowance for employees, whereas self-employed people do not have access to this benefit. If maternity and paternity pay entitlements were equalised for self-employed people and employees, the value remains unequal due to the characteristics of the different populations. In essence, should NICs rates change to fund such equalisation it would mean all self-employed people contribute to a benefit that far fewer self-employed people would actually qualify for because:

- There are fewer self-employed females (33% compared to 49% employees)
- 99% parental leave is taken by females
- 51% female SE work part-time (so would receive less statutory maternity pay)
- There are fewer people of childbearing age (aged between 16-49) in the self-employed workforce (56% compared to 72% employees)

Unsurprisingly, our research indicates self-employed people aged 30 or below placing a high value of SMP of 8.8 (figure 3.12), however there was again a difference in values depending on the business-type, with directors of their own limited company placing a low value of ***just 5.8***

1.3 The equalisation of NICs in relation to Job Seeker's Allowance

For employed individuals, National Insurance contributions currently contribute to the potential of individuals receiving Job Seekers Allowance (JSA) if they find themselves unemployed: self-employed NICs does not currently contribute towards JSA entitlement. Additionally, Job Seekers Allowance is being replaced by Universal Credit and, under the new regime introduced in April 2017, self-employed people are significantly disadvantaged simply by virtue of their status.

- FCSA research highlights that the 'value' (on a scale of 1 (low) to 10 (high)) that the SE place on their NICs contributing to the potential of obtaining JSA ***is just 6.5*** (figure 3.13)
- Ltd Co directors register much lower levels of interest in the benefit than Sole Traders and Ltd Partnerships.

1.4 Universal credit is not equal for self-employed people

Under Universal Credit the government has stipulated, from April 2017, that even if your self-employment is not earning you a profit of c.£12k per year after 12 months in business, it will assume this as a Minimum Income Floor before it starts to calculate your potential state-funded benefit entitlements By comparison, employees do not have any such minimum income floor applied to the calculation of their entitlements. According to the Office for Budget Responsibility, these changes to Universal Credit, which only affect self-employed people, will save the government £1.5 billion per annum

In terms of how unfair the current practice of applying a this level of Minimum Income Floor to Universal Credit calculations is, FCSA research evidences that amongst those that have completed their first year of business, ***more than half (51%) of all SE know that they did not achieve £12,000 profit in their first year of business – with a further 7% being uncertain/unable to remember (***figure 3.14)**.**

- ***64% of Sole Traders – the business type selected for the vast majority of self-employed – did not make a £12k profit in their first year.*** The figure is the same for Ltd Partnerships.
- Even amongst ***PSC directors, one third (35%) did not reach this profit threshold.***

Recommendations

19. If NICs for different employment statuses is to be reviewed, ensure that the self-employed security, rights and benefits are reviewed alongside this. Make any additional benefits (that presumably are provided in exchange for moves to equalise NICs) optional, or take a segmented approach dependent on business structure type given the evidence of differing wants, needs and views of sole-traders vs personal service company directors.

20. Remove the Minimum Income Floor for Univeral Credit for self-employed people; this policy change is flawed, unfair (penalising at least 50% of self-employed as evidenced in this report) and unnecessary.

A payroll tax?

Some think tanks have suggested introducing a payroll tax across all forms of employment, the key principle being to extend employers NICs to the self-employed workforce. Given that this review is likely to give the idea due consideration, we have gathered evidence[6] and we strongly advise the review panel to consider the following:

- Those that are incorporated businesses are subject to business taxation regulations and therefore a payroll tax would be double-taxation
- The financial burden to end-hirers who will need to pay the additional cost
- The administrative burden to end-hirers required to fulfil complex payroll administration instead of just their accounts payable function of paying a business directly
- The additional burden of engaging self-employed talent may be prohibitive, potentially diverting work to be undertaken by either:
    - Bigger consultancies - at increased cost to hiring businesses
    - Offshore suppliers - particularly as the digital age means roles can be undertaken anywhere in the world
    - The acceleration of automation replacing jobs

As such, we strongly encourage the government to understand the diversity within the demographics of the self-employed population – and its subsequent importance to UK plc, as a:

- Source of highly skilled flexible resource
- Source of innovation

We also remind the government of the importance of self-employment as the means of engagement that safeguarded the UK from high levels of unemployment in volatile times, particularly 2008 onwards.

By way of occupational profile (figure 4.1), half (49%) of all self-employed are in senior, professional or associate professional roles. A further quarter (26%) are in skilled trades. And in terms of the growth since Q4 2008, 69% (656k) of the growth (955k) through to Q4 2016 has been at the highly skilled end of the spectrum in the following ONS categories:

- managers, directors & senior officials;
- professional occupations;
- associate professional & technical

Figures 4.2 and 4.3 show self-employed numbers and percentages by occupation in Q4 2008 and 2016 according to ONS data. Our analysis evidences that 60% of all self-employed people work within five

[6] Appendix 4

sectors, led by construction. We also know that 65% of the growth in self-employment between 2008 and 2016 has been within five sectors, led by professional, scientific and technical, as below:

Rank by # self-employed Q4 2016	Industry sector	Q4 2016 Number		Rank by % of total growth in SE between Q4 2008-16	Industry sector	Growth in # between Q4 2008-16
1	Construction	939,000		1	Professional, scientific & technical	192,000
2	Professional, scientific & technical	624,000		2	Education	129,000
3	Other Services (R,S & T)	569,000		3	Other Services (R,S & T)	121,000
4	Wholesale & retail (+ motor vehicle repairs)	402,000		4	Admin & support services	98,000
5	Admin & support services	347,000		5	Information & communication	80,000
Total of top 5		**2,881,000 (60%)**		**Total of top 5**		**620,000 (65%)**

Source: FCSA analysis of ONS data

A key characteristic of industries with a history of above-average dependency on self-employment within their composite workforce is the project-based work nature of their outputs. These include Construction and Professional and Scientific & Technical industries. Flexibility and short-term access to key strategic skills, as required, underpin the efficiency and competitiveness of these industries.

If employers were to face a significant cost uplift, by virtue of applying a Payroll Tax across all forms of labour there could be significant economic consequences for both UK plc and those seeking employment opportunities:

1. Projects becoming unviable, due to the increase in workforce costs:
   - Within construction, where 41% of the workforce is self-employed, projects will either become significantly more expensive (notably impacting the public purse, as the industry is driven by public sector infrastructure projects) or will stall, impacting UK employment.
   - Many 'Other Services' – which are often consumer orientated - where 32% of the workforce is self-employed, will simply become affordable

2. The likelihood that some of this work would be undertaken overseas, if wage costs spike:
   - Professional, Scientific and Technical work, where 27% of the workforce is self-employed, can largely be performed anywhere in the world where the skills exist. Whilst the UK is noted for its pool of high-end skills, employers will seek alternative delivery locations (and/or delivery solutions) if costs become inflated overnight.
   - Admin & Support Services, where 23% of the UK workforce is self-employed, largely relies on a semi-skilled workforce. With such skills available globally combined with access to technology, off-shoring is already well established within these disciplines. Therefore alternatives to a UK workforce can be easily accessed should increased costs be an issue.
3. The potential that the automation of this work would be accelerated
   - As well as the potential for employers to consider the off-shoring of Admin & Support Services, where 23% of the workforce is self-employed, there is also the likelihood that employers will accelerate consideration of the automation of work/tasks if labour costs dramatically increase.

Impact on non-UK nationals

With uncertainty over employers' continued access to the skills of non-UK nationals continuing to hang in the balance – not just in relation to what governments may agree between on immigration policies, but also by virtue of shifting worker sentiment about where people will chose to work in the future – it is important to also consider self-employment amongst this cohort. See figures 4.4 and 4.5.

- Self-employment levels varied significantly by nationality group.
  - This ranged from 14.0% for EU14 nationals to 24.9% amongst Romanian & Bulgarians (EU2) in 2016.
- Non-UK nationals working on a self-employed basis numbered in the region of 530k in 2016.

When considering the occupations in which non-UK nationals work on a self-employed basis, other sectors come into subsequent focus once their vulnerability to the potential future loss of access to skills is added to the potential of increased workforce costs by virtue of a payroll tax extending across self-employed labour. These include Public Admin, Education & Health, Financial & Business Services and Retail, Hotels & Restaurants.

When looking the non-UK national component of the entire workforce of each industry (figure 4.6), the Retail, Manufacturing, Construction (trades) and Public Services sectors are already challenged by the growing uncertainty over the future availability of workers upon whom they have become reliant. Further cost pressures, in such a volatile period as Brexit is about to unleash, may well be a challenge too many for a host of UK employers.

Impact on part-time workers

Furthermore, if a payroll tax is added to all forms of worker engaged by an employer, it could have a disproportionate impact on part-time employees - many of whom are umbrella employees working across numerous end-hirers, for example within education and health sectors. Should a payroll tax be introduced it will potentially mean that part-timer wage costs would significantly increase, leaving this cohort vulnerable to reduced hours, offshored or replaced by other means of fulfilling roles such as automation.

Unlike self-employment, which is concentrated into four occupations, part-time employment is more proportionally spread across the skills groups (figure 4.7). As such, there is even greater potential that a payroll tax, applied to a significant proportion of the 8.5m part-time workers who currently earn under the weekly NICs threshold, would have a significant cost impact on a broad spectrum of employers.

Crucially, however, when looking at how significant part-time employment is in context of the total workforce of each key occupational group (figure 4.8) there are four areas where the proportion exceeds the average (22%). These include Admin.& Secretarial (33%), Sales & Customer Service (50%), Caring, Leisure & Other Services (37%) and Elementary Occupations (43%).

If such sizeable cohorts of workers were to attract a Payroll Tax in the future, we anticipate the following impacts on the part-time workforce, by reference to the same headings used earlier:

1. Projects becoming unviable / services becoming commercially unviable, due to the increase in workforce costs:
   - Within Caring, Leisure & Other Services and Elementary Occupations , where 37% and 43% of their respective workforces are part-time employees – and employers are already having to contend with rising National Living / Minimum Wage rates and pension contributions - providers would simply cease to operate in areas of restricted funding (namely public services) if their major cost (labour) rose considerably.
2. The likelihood that some of this work would be offshored, if wage costs hike:
   - Within Sales & Customer Services, where 50% of the workforce are part-time employees, off-shoring is so well established as an alternative to on-shore customer services, alternative solutions may be easily accessed if notably increased costs force such a consideration.
3. The potential that the automation of this work would be accelerated
   - From a Retail Sales perspective – where employers are also already having to contend with rising National Living / Minimum Wage rates and pension contributions - FCSA analysis determined that 53% of all those in employment within the sector were part-time employees. As such, the likelihood of the acceleration of the automation should be anticipated if workforce costs were to rise suddenly.
   - Similarly within Admin & Secretarial functions, where 33% of roles are on a part-time employment basis, automation would be an obvious alternative consideration if prompted by escalating wage costs

Recommendations

23. Do not introduce a payroll tax: it will render many public services unaffordable and will lead to an increase in offshoring and/or an acceleration of automation.

Pace of change

There have been numerous tax and legislation changes affecting our sector in recent years, and we believe it is logical to evaluate the impact of these before embarking on further changes. The regulatory policy committee (RPC) echoed this view in their review[7] published in February 2017:

> *"As both the national audit office and public accounts committee noted, monitoring, evaluation and review are essential to the policy-making process in order to:*
>
> - *improve government's understanding of how regulatory interventions work in practice by learning from experience*
> - *gather evidence to assess the on-going need for intervention*
> - *highlight where further interventions are required, or whether non-regulatory actions are now appropriate;*
> - *improve the use of evidence and analysis in appraisal*
> - *understand the unintended consequences of specific regulations, and where interventions have produced unexpected results*
>
> *RPC will continue to press for departments to produce high-quality post-implementation reviews of significant measures"*

This review of effectiveness of recent legislation should form part of a wider holistic review to balance the broad spectrum of needs and create a viable roadmap for change. Some suggestions for recent legislative changes needing a review of their effectiveness includes:

1. IR35 changes in the public sector (effective April 2017) –
   Already discussed at length and MUST be properly reviewed before any further changes are brought in within the self-employed sector.

2. Tax relief on travel and subsistence expenses (effective April 2016)
   This change removes the ability for contractors working through an intermediary (agency or umbrella firm) to claim tax relief on their travel and subsistence expenses unless it can be proven that they are not subject to the right of supervision, direction or control of the end-hirer. This has effectively made 90% of umbrella employees and agency workers financially worse off, and has reduced their reward for choosing contracting, i.e. non-permanent employment. Rules are being applied inconsistently by intermediaries with increasing numbers simply ignoring the legislation believing that they will not get caught.

3. Salary sacrifice changes (effective April 2016)
   A last minute amendment to the finance bill was made in order to specifically target umbrella firms, ensuring that any umbrella employees who are eligible for tax relief on their travel and subsistence expenses cannot receive this relief at source when they receive their employment income from the umbrella firm – unless the umbrella amends its financial model such that taxable pay does not vary with expenses. This is complex in practice and the changes deliberately and unfairly target contractors who choose umbrella.

[7] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/593213/RPC_Report_-_Review_of_Government_impact_assessment_capability_-_February_2017.pdf

4. Onshore intermediaries (effective April 2014)
   The policy makes intermediaries for employment taxes and NICs if they place a worker who is later found to be falsely self-employed. Umbrellas are a solution as they employ the worker so large numbers of people were moved en masse, even if they were genuinely self-employed. The construction sector was particularly affected, with large numbers no longer being taxed through the Construction Industry Scheme. Now that the marketplace has got better at determining whether someone is genuinely self-employed, we are seeing a resurgence back to the Construction Industry Scheme.

5. Removal of flat rate VAT (effective April 2017)
   Rather than properly regulating misuse of the flat rate VAT scheme, instead HMRC decided to eradicate it entirely for businesses that have low costs. This significantly disadvantages genuinely self-employed people, adds cost to the supply chain (due to accounting complexities) and is likely to result in more dubious models.

This list is not exhaustive as there is a need to properly review the effectiveness of other recent legislation affecting contractors, and FCSA would be pleased to advise further.

In summary, we must not inhibit the growth of the UK economy by imposing restrictions on the creation of flexible employment or indeed permanent employment in whatever form. Given the current Brexit uncertainties for a minimum period of two years and possibly beyond that, a stable platform for growth and economic prosperity must be at the heart of the UK's employment strategy.

In order to make the necessary adjustments to the taxation system one must firstly recognise new employment models and drivers designed to stimulate growth, protect the vulnerable and recognise new ways and new needs. When we have clarity of direction then the tactical objectives can be addressed in a more permanent and symbiotic manner.

There is universal recognition that workforce flexibility is a key competitive advantage to the UK, and is (rightly) here to stay.

Recommendations

24. Undertake a considered review of the effectiveness of recent legislation impacting the contingent workforce

25. Do not introduce any further legislation without having first learnt lessons from other recent changes, including but not limited to: IR35 changes, tax relief on travel and subsistence expenses, salary sacrifice changes, onshore intermediaries, removal of flat rate VAT.

Contact details for further information

If you would like further information on any aspect of this response, please do not hesitate to contact:

Freelancer & Contractor Services Association

APPENDIX 1: Operating models that are NOT umbrella

Shell company model

A number of providers within the marketplace operate a "shell company model" which puts workers into companies without their knowledge, often with offshore directors who have ultimate responsibility for the worker's company. The providers of such schemes profit from operating the shell companies to take advantage of the annual employment allowance (worth £3,000 towards employment NICs every year for eligible companies), and the manipulation of the flat rate VAT scheme. Furthermore, a number of such scheme operators flout rules regarding tax relief on travel and subsistence expenses despite legislation changes that came into effect in April 2016.

Disguised remuneration schemes

Several schemes exist that seek to disguise remuneration paid to individuals and therefore reduce the tax that is paid to the Exchequer. Such scheme providers are not umbrella firms but they compete in the same market as a means of paying contractors who are often enticed by the higher net income on offer, 90% net pay in some instances. HMRC is aware of such schemes and is taking action, and we have summarised the main types:

1. Contractor loan schemes

Loan schemes work by paying the contractor a very low salary with the rest of the income paid as a loan (less their usually high fees). Some providers use an offshore loan claiming this escapes HMRC, which it doesn't. Contractors sign up to this type of scheme in good faith after promises that when they leave (finish their assignment) the loan would be written off. The problem is that as soon as the loan is written off it becomes taxable in full.

If the loan is not written off, then the contractor still owes the money to the scheme provider. This money can be called in at any time and at any point in the future. There is also the risk of being hit twice for the debt. The "loan" is effectively a benefit in kind (BIK) and if it is not declared on their tax return as income, the individual will potentially face a huge tax bill and fine, on top of paying back the original loan.

HMRC have issued a Spotlight on such schemes - http://ow.ly/F2YY30bBBe7

2. Employee benefit trusts (EBT)

This is a trust established either in the UK or offshore, set up by a company to hold cash and other assets such as shares, to provide benefit to employees. Trust beneficiaries can include past and present employees of the company and its subsidiaries, and their families and dependents. Furthermore, an EBT is complicated to set up and reliant on the compliance of offshore trustees, meaning that the promised benefits cannot be guaranteed. Characteristics might include:

- Payment of bonuses via an offshore trust in an attempt to avoid employers' NICs
- Payment of remuneration by way of loans, which may be written off before they become repayable

- Making loans in depreciating currency from which the borrower may make a foreign exchange gain before the loan becomes repayable
- Allowing employees to use assets (such as cars) owned by the EBT, the costs of acquiring which would be capital expenditure if they were owned by the employing company
- Providing benefits in the form of shares (not in the employing company) whose values can be most easily manipulated before or after they are transferred from the EBT to employees or directors.

HMRC view EBTs as a means of disguising remuneration and therefore reducing tax and NICs due on earned income, so the 2011 Finance Bill contained provisions intended to stop their usage. Despite this, we are aware that such schemes still exist within the marketplace today.

3. Schemes involving annuities

Similar to the contractor loan scheme outlined above, but this type uses annuities instead of a loan in order to minimise tax paid. It splits income into two payments, one taxable salary is set very low so that minimal tax is paid, and the other portion is a capital payment for a deferred annuity, which the provider claims is not taxable. (An annuity is a form of investment where a person pays a lump sum, usually to a pension company, in return for a guaranteed income either for life or a fixed period.)

HMRC state that the scheme doesn't work and that they will investigate all users of the scheme. They have issued a Spotlight which can be read here: http://ow.ly/JCWm30bBBl3

4. Schemes involving job boards / marketing expenses

This arrangement again involves a contractor receiving payment in two parts; a small basic wage incurring minimal tax and NICs, with the remainder of the payment used to advertise contractor's services on a job board. They immediately receive loyalty points in exchange, which can be cashed in shortly after with little or no tax or NICs deducted. HMRC state that receiving and redeeming the loyalty points is taxable income, which forms part of the contractor's employment income from the company.

Contractors could end up worse off because they'll still owe the tax and NICs, plus interest and any fees charged by the promoter.

FCSA informed HMRC about this scheme when it emerged, and they produced a Spotlight which can be read here: http://ow.ly/IL0P30bBBow

Elective deduction model

This is similar to umbrella except that it is cheaper option for the scheme provider because they do not actually employ the individual. The elective deductive model basically requires the worker to be self-employed for employment status, but to elect to be taxed as an employee for their tax status. So they *elect* to have additional *deductions* processed from their pay.

This is not umbrella because workers are <u>not actually employed</u> therefore do not automatically have any rights or benefits

Whilst it is possible to run this model ethically, it nevertheless exposes the worker to potential exploitation, because being self-employed means that they receive no rights or protections so they are in an extremely precarious position. It means that the scheme provider does not need to pay them the minimum wage, nor provide comparable pay to permanent employees in similar roles (AWR), nor provide statutory leave, etc etc. However despite receiving no rights or benefits, the individual is still taxed as an employee.

This model is legal, however FCSA has sought government views due to concerns about potentially exploiting workers:

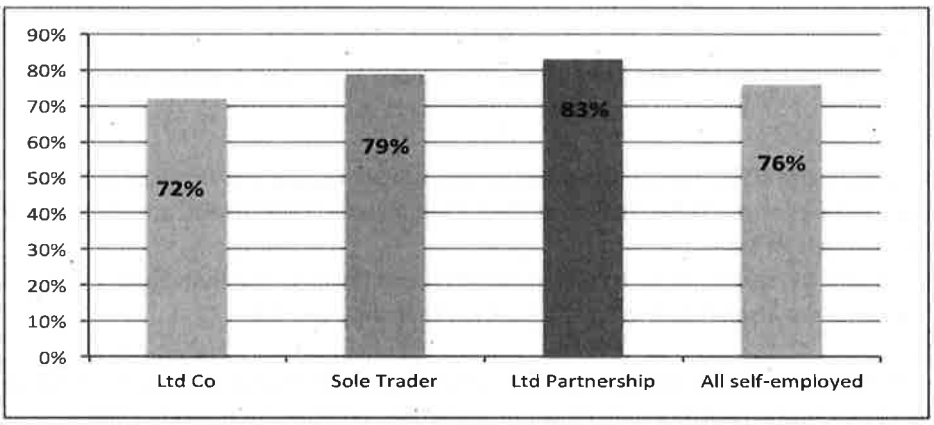
- We have sought HMRC's view, however because tax is being paid (by virtue of the individual electing for this to be deducted from their income) then HMRC are limited as to the position they can take.
- We have sought BIS's view (prior to becoming BEIS) and because the individual is self-employed, they are also limited as to the position that they can take

If no action is taken, there will be continued growth of this model in the marketplace. As it is legal and we have received no advice to the contrary, we allow our associate members to operate EDM.

APPENDIX 2: data relating to tax considerations

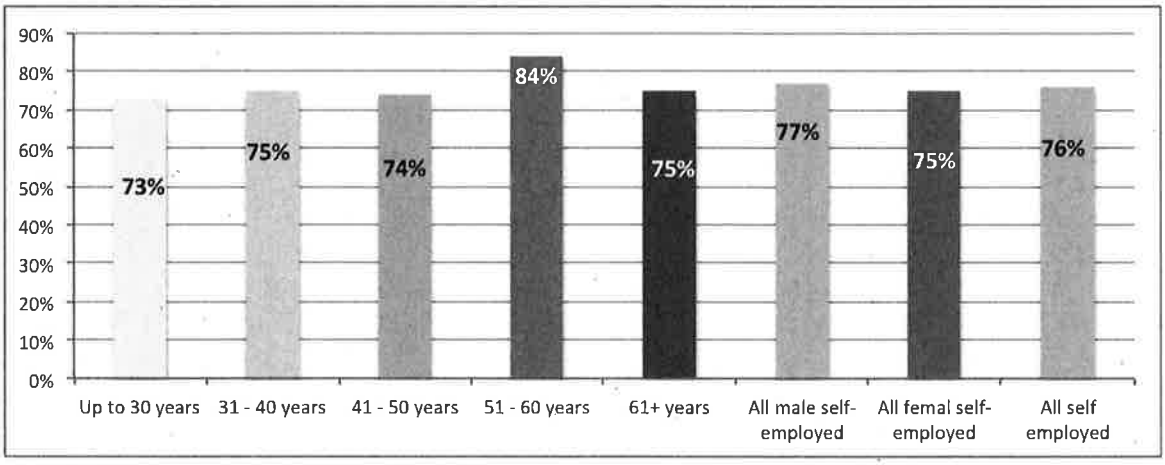
Provision for sickness absence

Figure 2.1: Percentage of self-employed, by business type, with no provisions for sickness, holiday or redundancy / major client loss



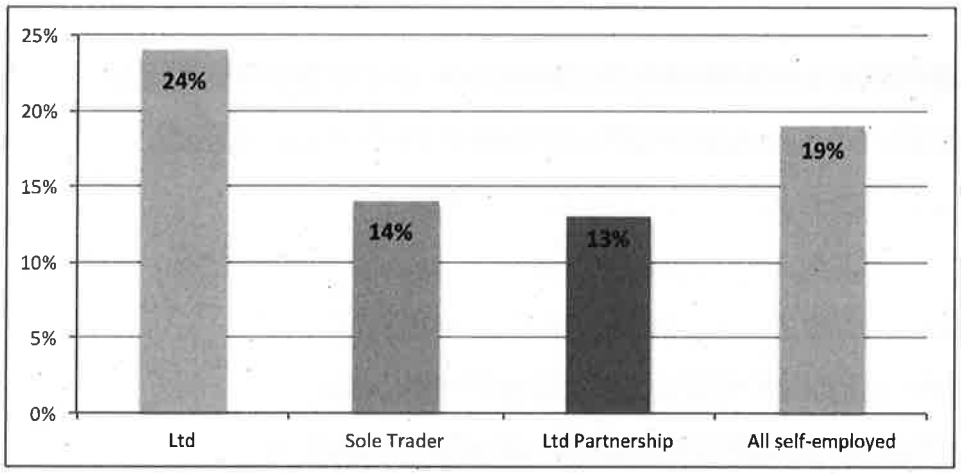
Source: FCSA / FreeAgent Self-Employment survey, May 2017

Figure 2.2: Percentage of self-employed, by age or sex, with no provisions for sickness, holiday or redundancy / major client loss



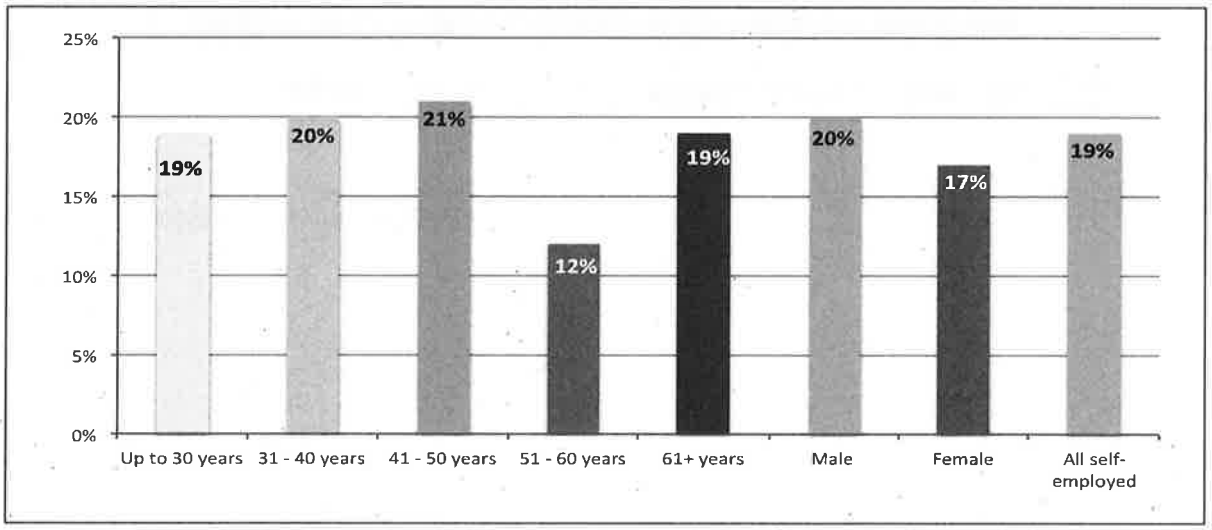
Source: FCSA / FreeAgent Self-Employment survey, May 2017

Figure 2.3: Percentage of self-employed, by business type, with sick pay provision in place



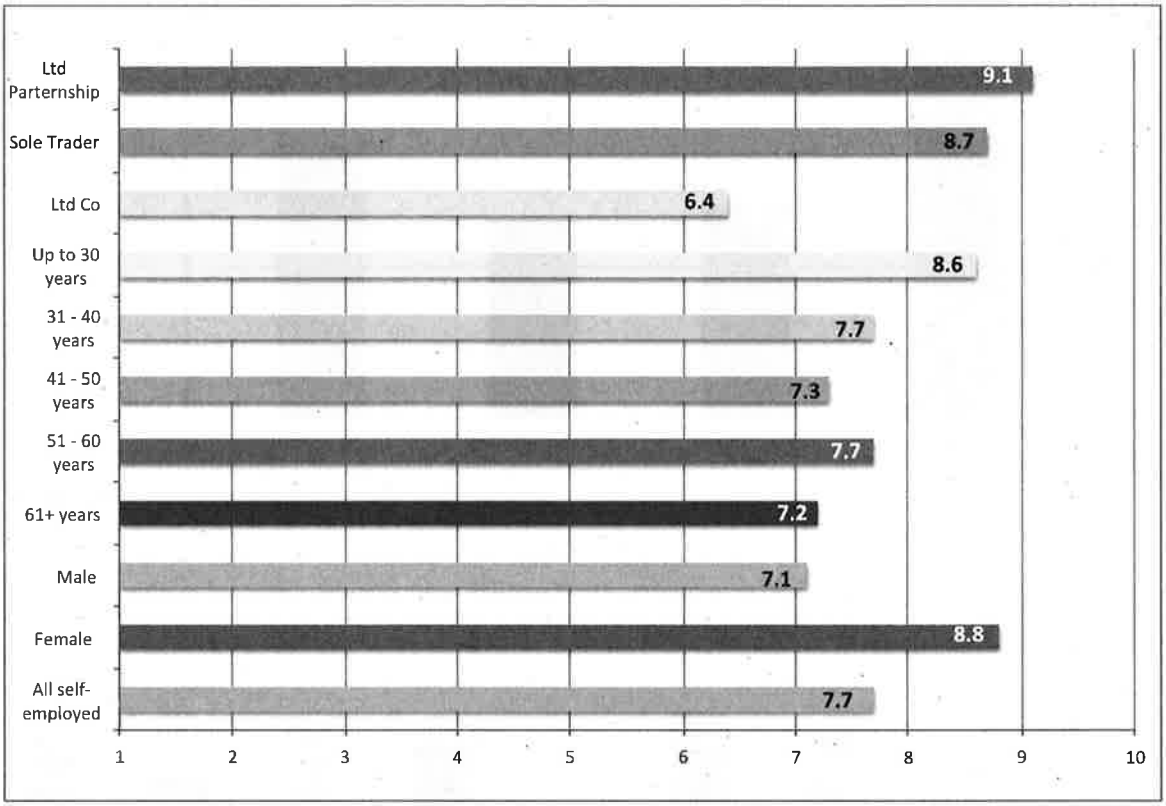
Source: FCSA / FreeAgent Self-Employment survey, May 2017

Figure 2.4: Percentage of self-employed, by age and gender, with sick pay provision in place



Source: FCSA / FreeAgent Self-Employment survey, May 2017

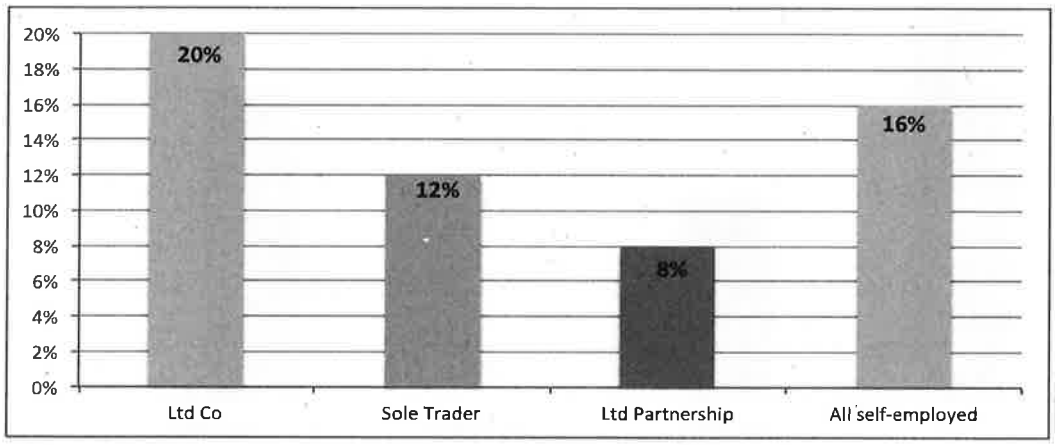
Figure 2.5: The value of sick pay provision to the self-employed, rated on a scale of 1 (low) to 10 (high)



Source: FCSA / FreeAgent Self-Employment survey, May 2017

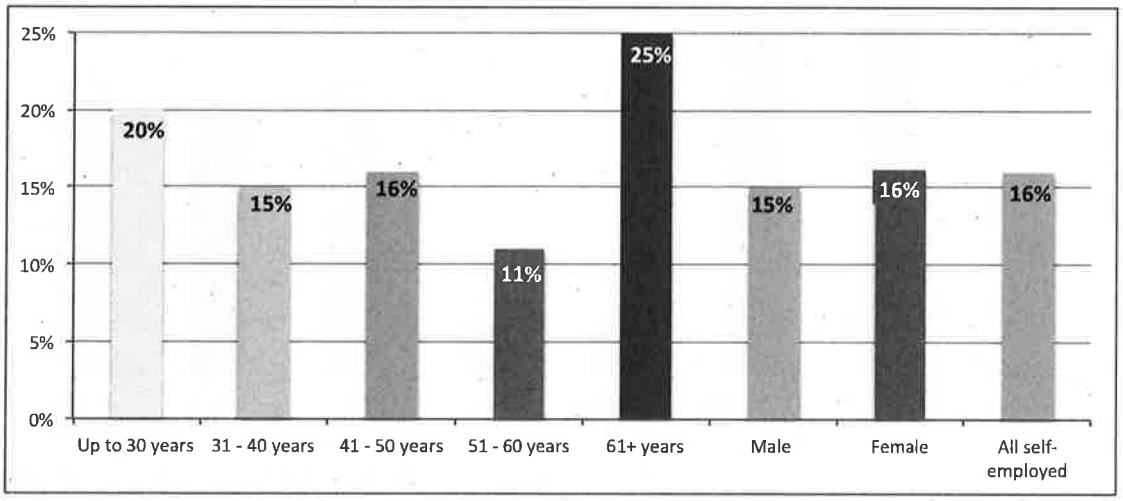
Provision for holiday absence

Figure 2.6: Percentage of self-employed, by business type, with holiday provision in place in their business



Source: FCSA / FreeAgent Self-Employment survey, May 2017

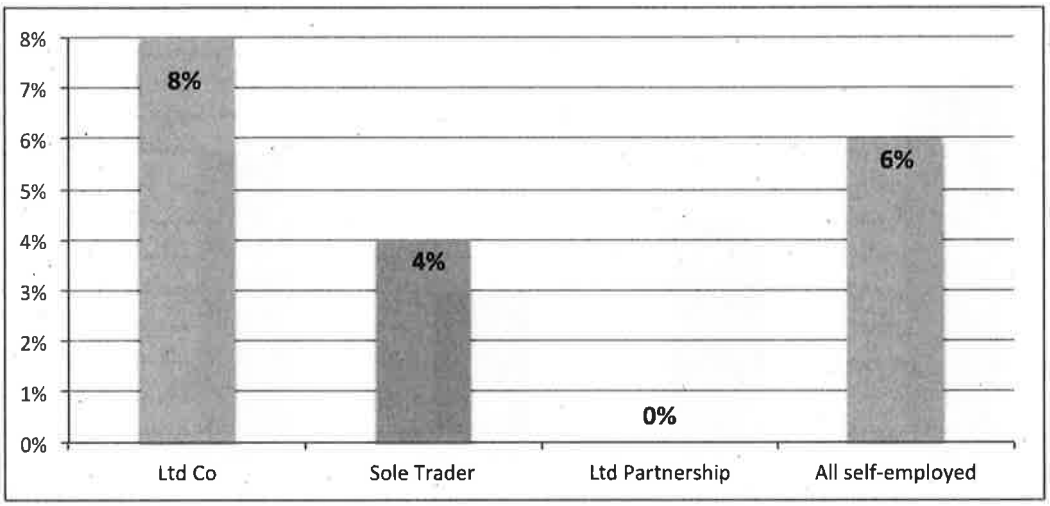
Figure 2.7: Percentage of self-employed, by age and gender, with holiday provision in place in their business



Source: FCSA / FreeAgent Self-Employment survey, May 2017

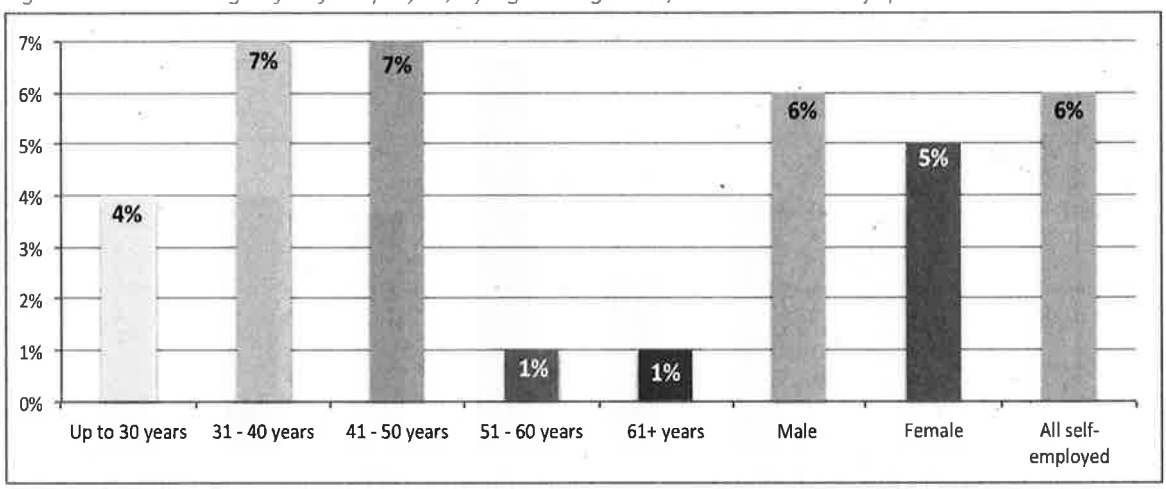
Provision for sudden loss of work

Figure 2.8: Percentage of self-employed, by business type, with 'redundancy' provision



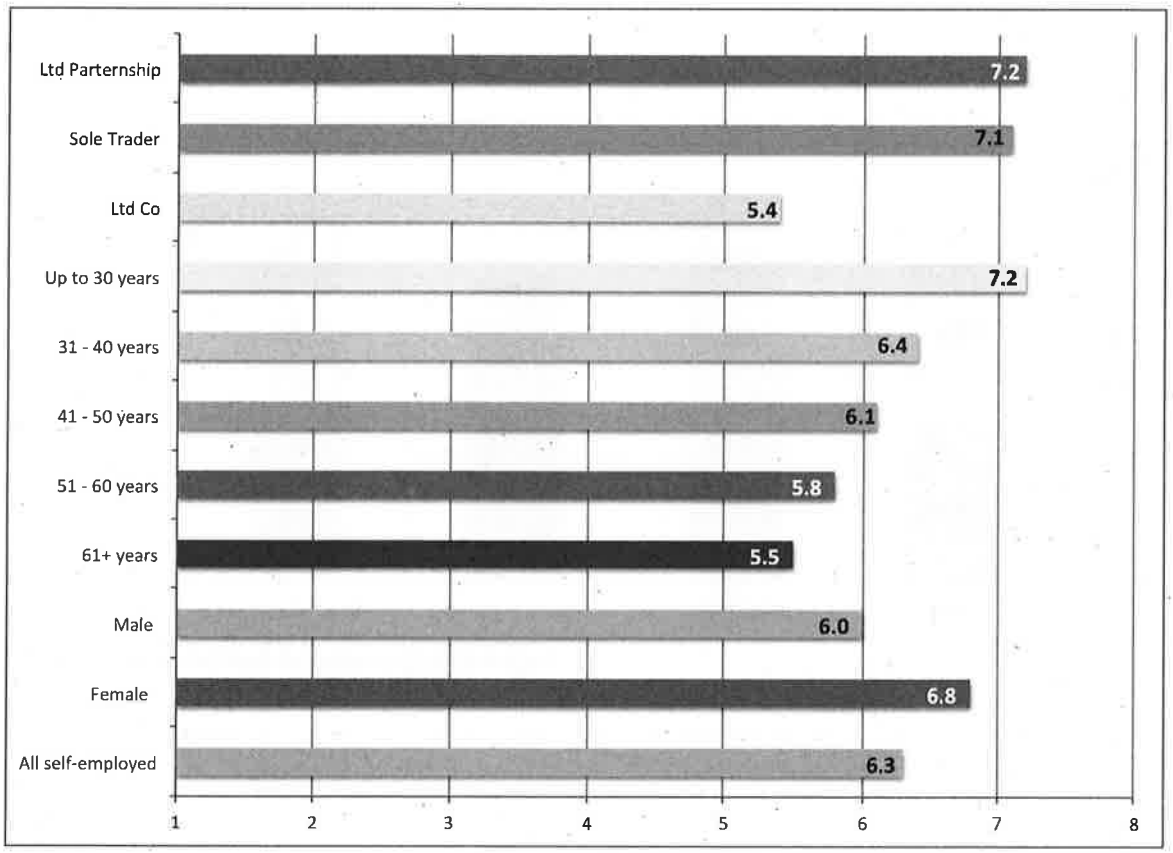
Source: FCSA / FreeAgent Self-Employment survey, May 2017

Figure 2.9: Percentage of self-employed, by age and gender, with 'redundancy' provision



Source: FCSA / FreeAgent Self-Employment survey, May 2017

Figure 2.10: The value of 'redundancy' entitlements to the self-employed, rated on a scale of 1 (low) to 10 (high)

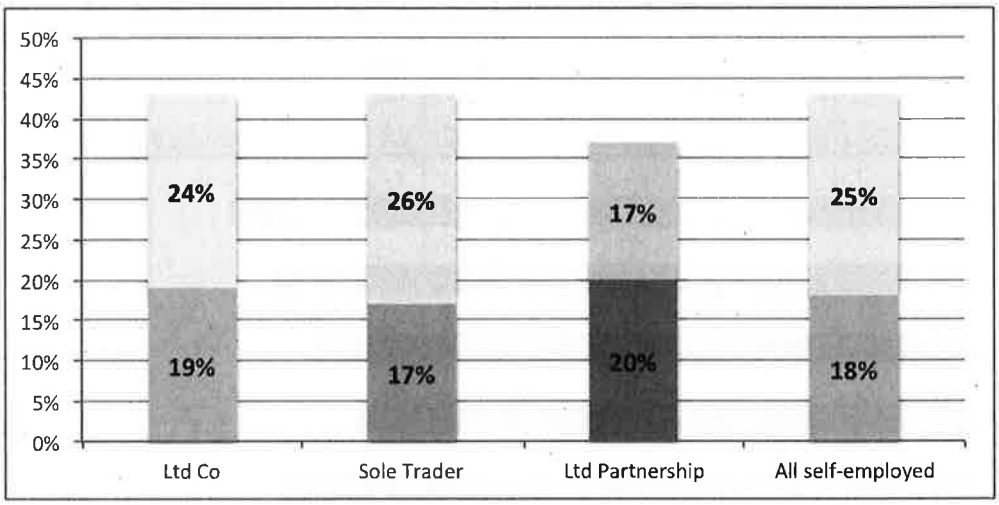


Source: FCSA / FreeAgent Self-Employment survey, May 2017

APPENDIX 3: data for NICs considerations

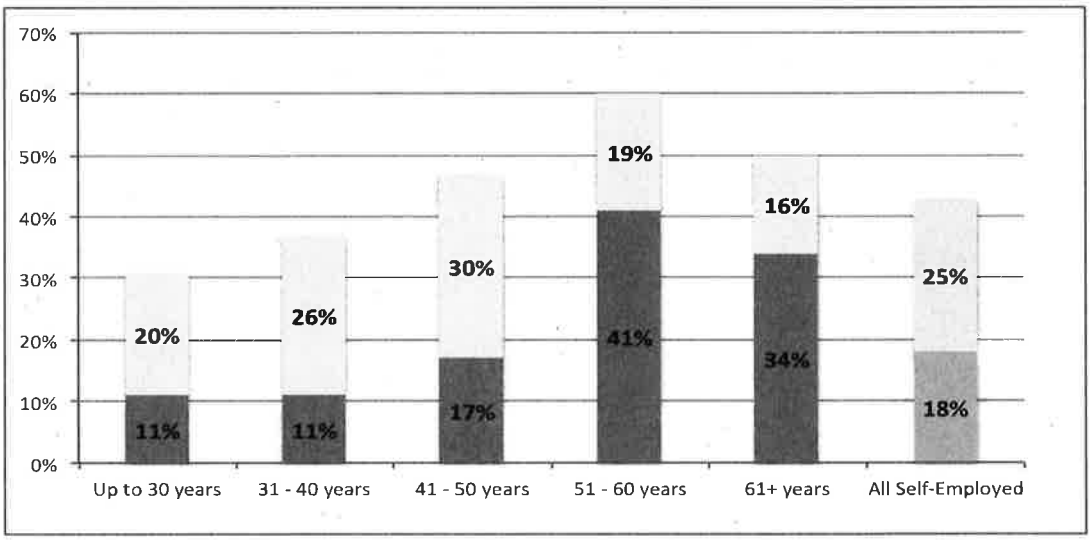
Data relating to pension provision

Figure 3.1: The proportion of self-employed contributing to a State pension (via NICs), who either know or do not knowing how many years they must contribute to qualify, by business type



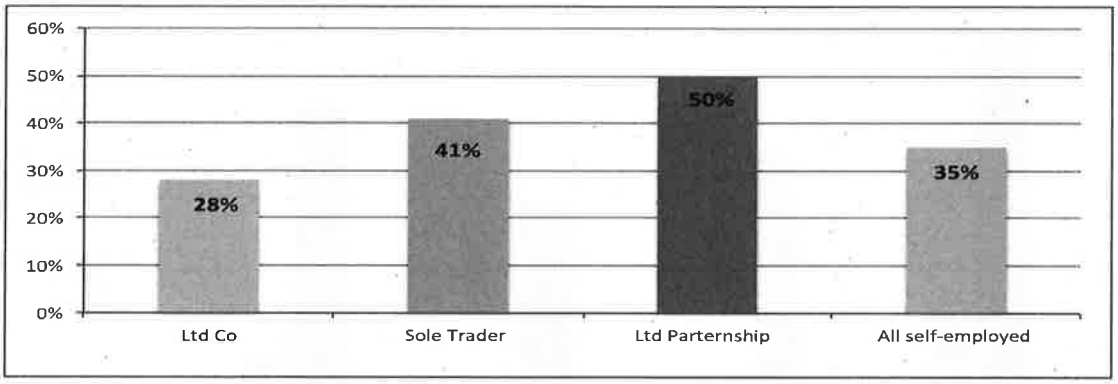
Source: FCSA / FreeAgent Self-Employment survey, May 2017

Figure 3.2: The proportion of self-employed contributing to a State pension (via NICs); who either know or do not knowing how many years they must contribute to qualify, by age band



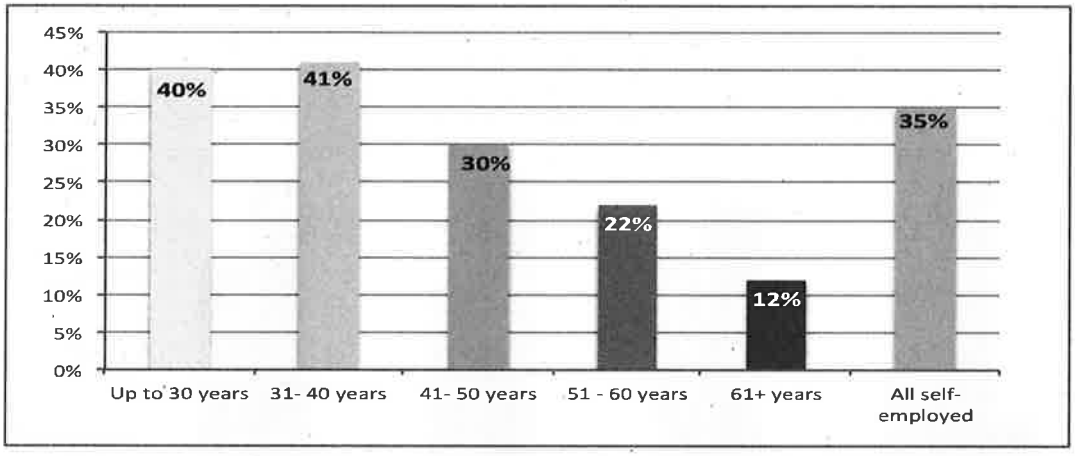
Source: FCSA / FreeAgent Self-Employment survey, May 2017

Figure 3.3: The proportion of self-employed, by business type, with no plans / arrangements to fund their retirement



Source: FCSA / FreeAgent Self-Employment survey, May 2017

Figure 3.4: The proportion of self-employed, by age band, with no plans / arrangements to fund their retirement



Source: FCSA / FreeAgent Self-Employment survey, May 2017

Figure 3.5: The proportion of all self-employed with secondary pension schemes

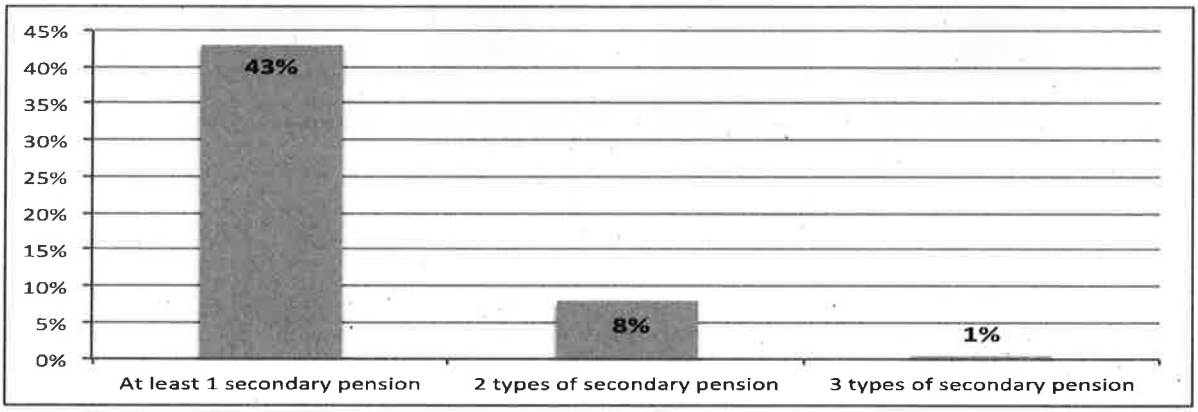
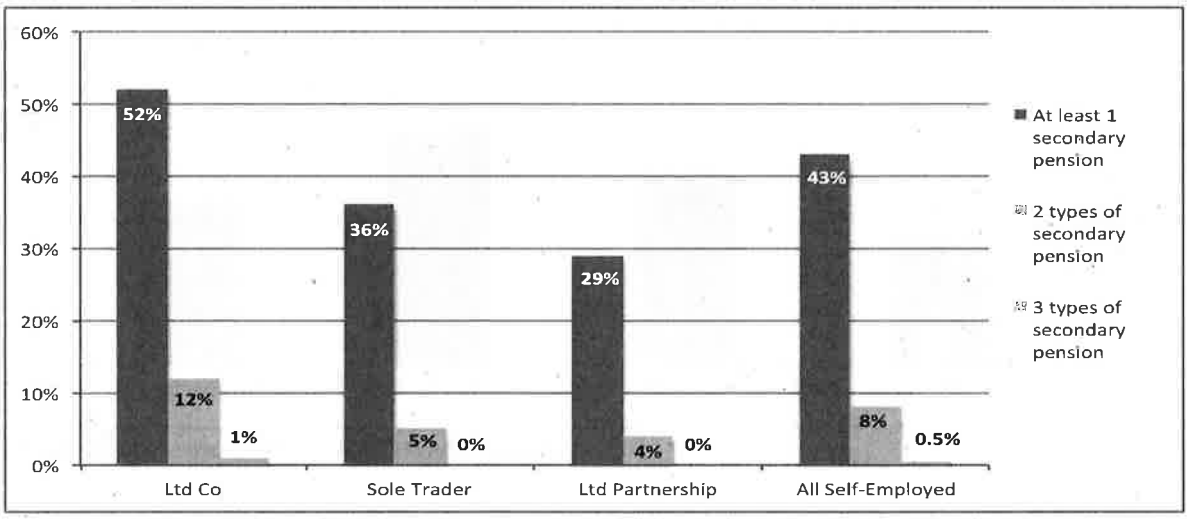


Figure 3.6: The proportion of all self-employed with secondary pension schemes, by business type



Source: FCSA / FreeAgent Self-Employment survey, May 2017

Figure 3.7: Secondary pension plan type (amongst those with at least one secondary pension), by business type

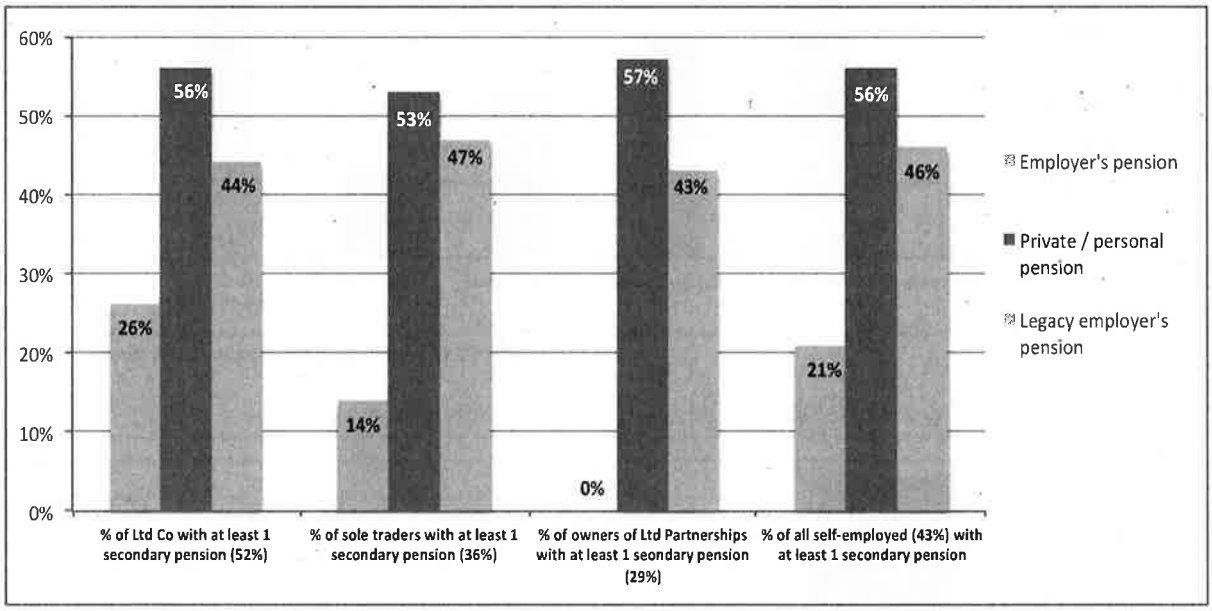
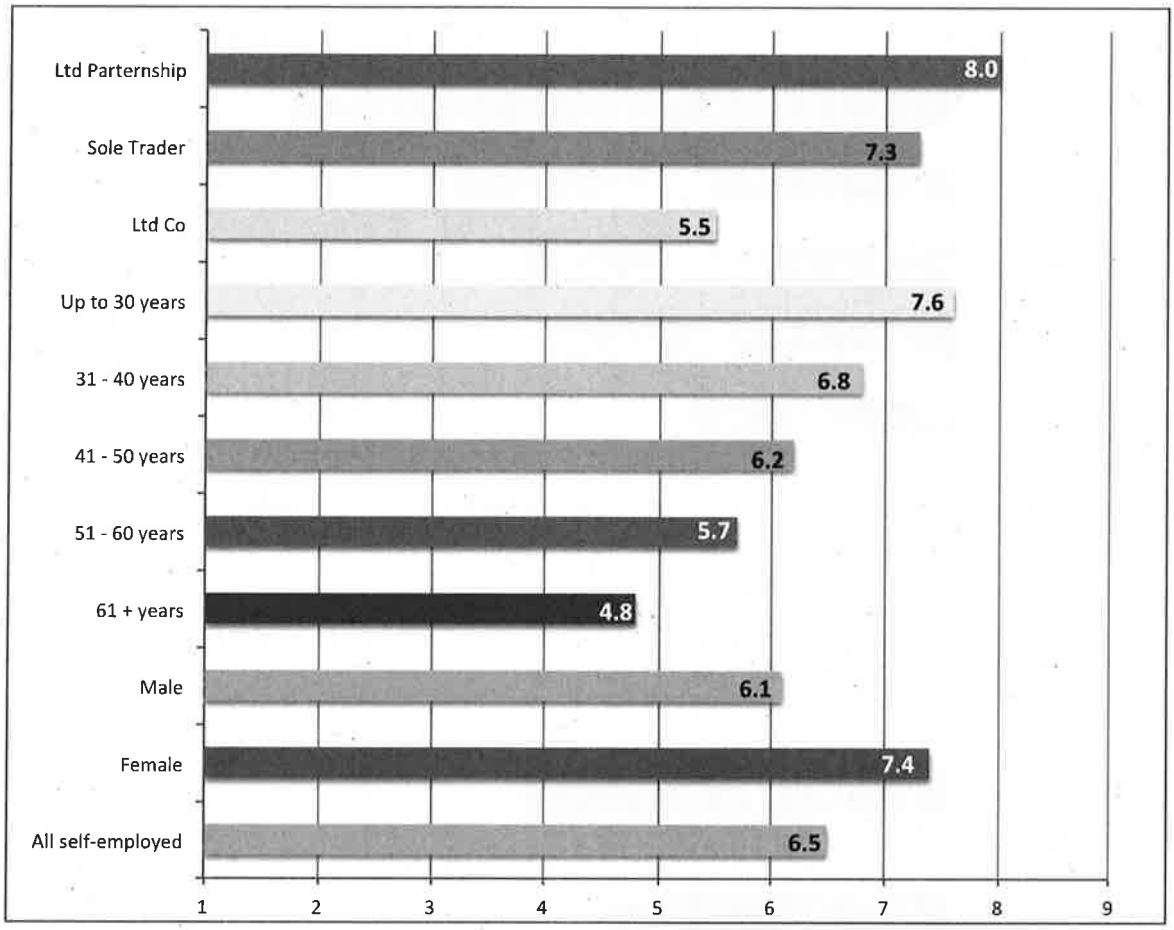


Figure 3.8: The value pensions auto-enrolment to the self-employed, rated on a scale of 1 (low) to 10 (high)



Source: FCSA / FreeAgent Self-Employment survey, May 2017

Figure 3.9: Percentages of self-employed who would opt out of pensions auto-enrolment, or are undecided, by business type

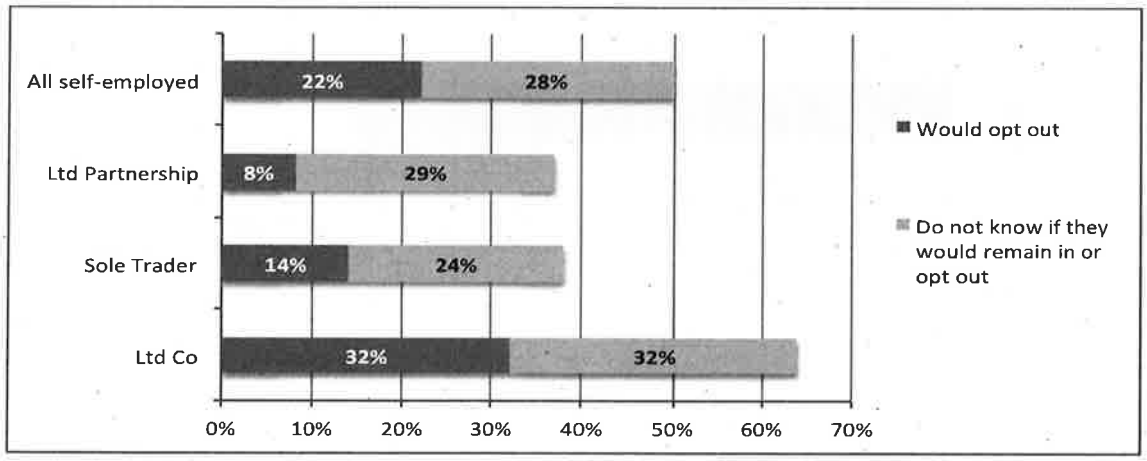
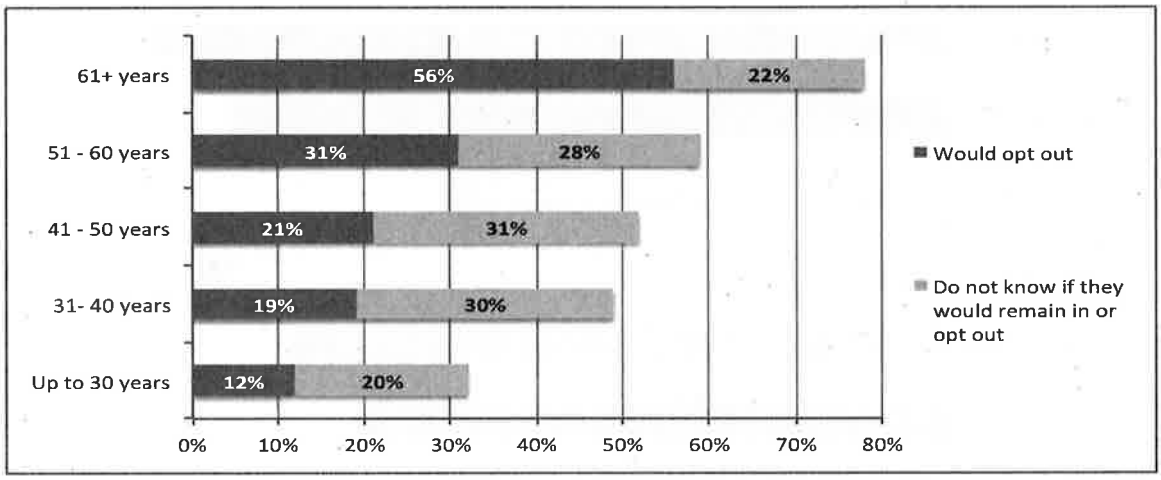
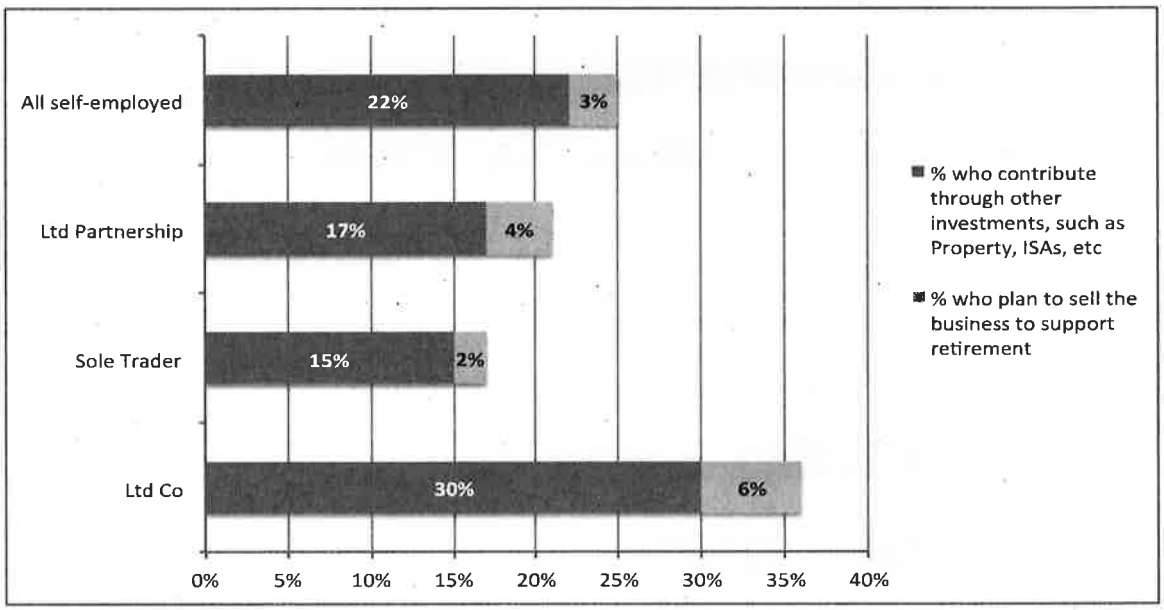


Figure 3.10: Percentages of self-employed who would opt out of pensions auto-enrolment, or are undecided, by age



Source: FCSA / FreeAgent Self-Employment survey, May 2017

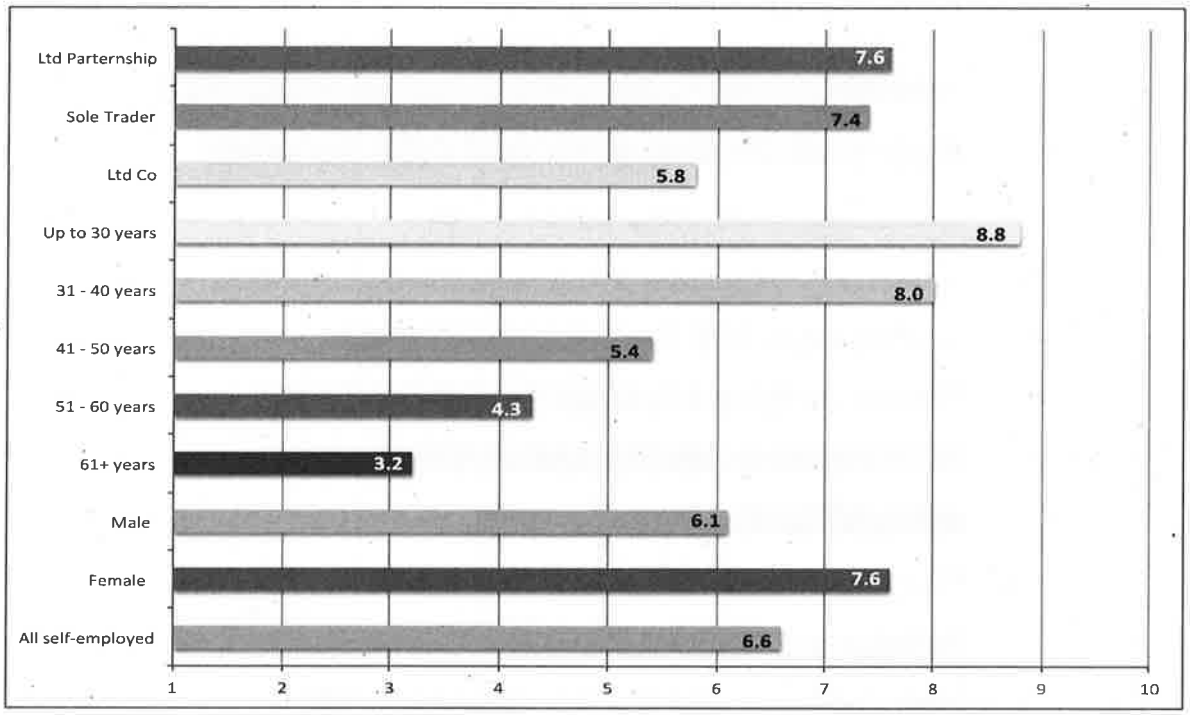
Figure 3.11: The percentage of self-employed who are making other arrangements (beyond pensions) to fund their retirement, by business type



Source: FCSA / FreeAgent Self-Employment survey, May 2017

Data relating to maternity, paternity and adoption pay entitlements

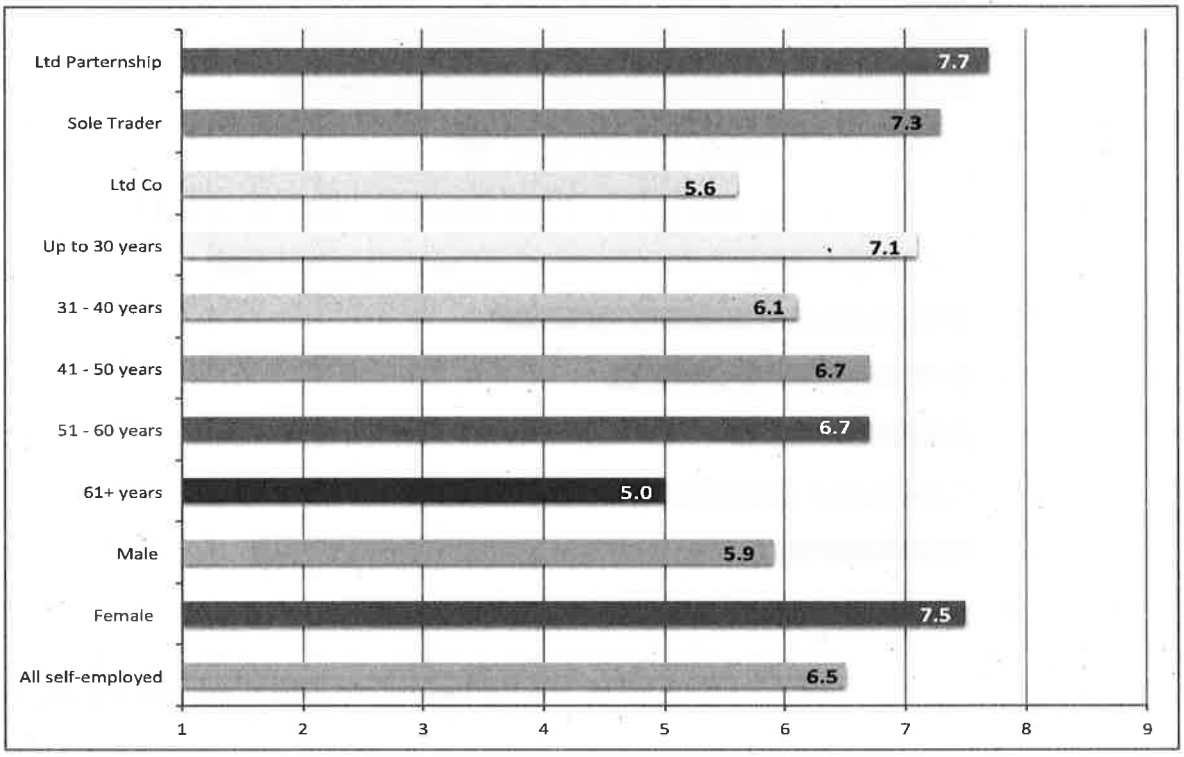
Figure 3.12: The value of mat / pat / adoption pay to the self-employed, on a scale of 1 (low) to 10 (high)



Source: FCSA / FreeAgent Self-Employment Survey, May 2017

Data relating to Job Seeker's Allowance

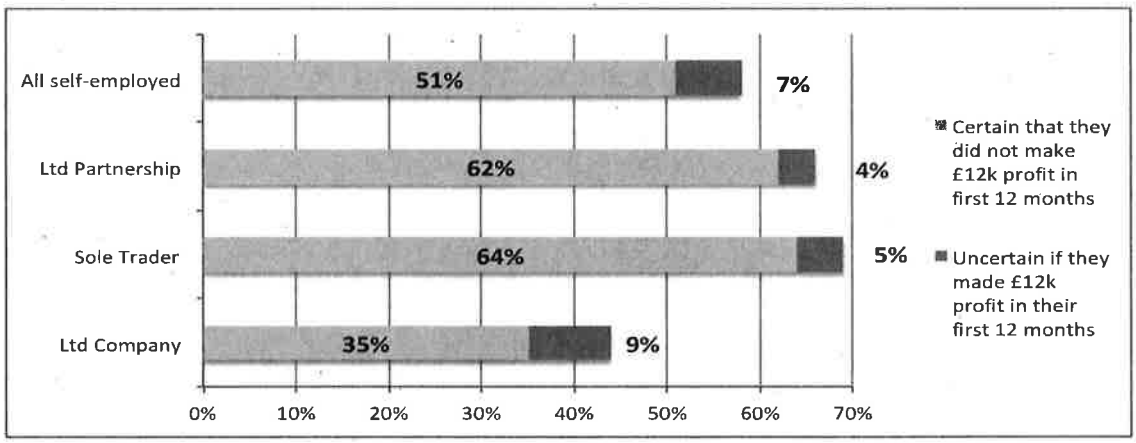
Figure 3.13: The value to the self-employed of their NICs contributing to the potential of receiving Job Seeker's Allowance, rated on a scale of 1 (low) to 10 (high)



Source: FCSA / FreeAgent Self-Employment Survey, May 2017

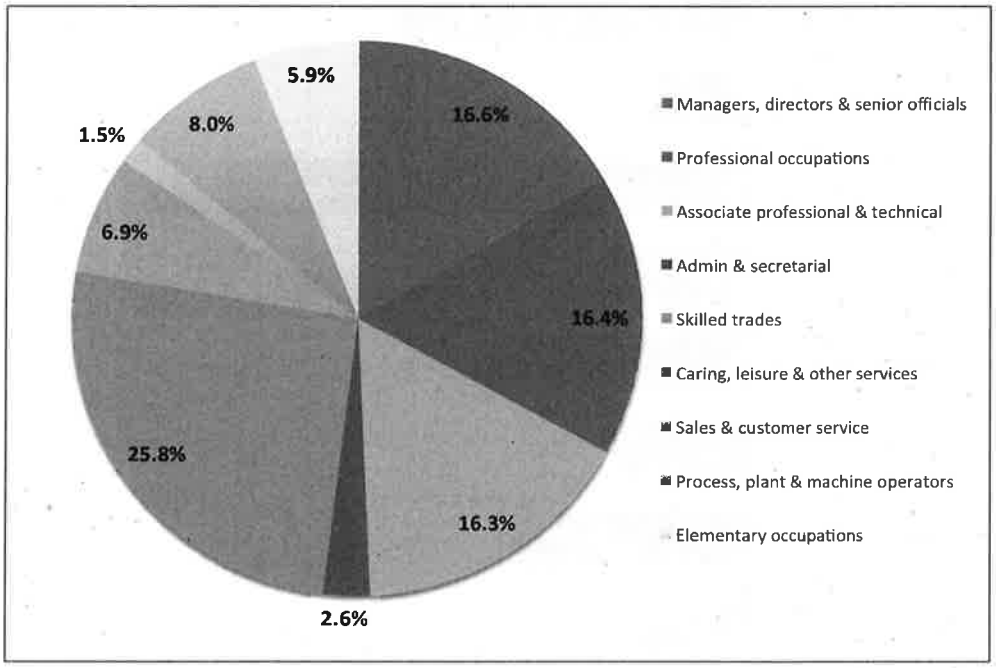
Data relating to Universal credit

Figure 13.14: The proportion of self-employed who are certain that they did not achieve £12k profit in their first 12 months in business and those that are uncertain, by business type



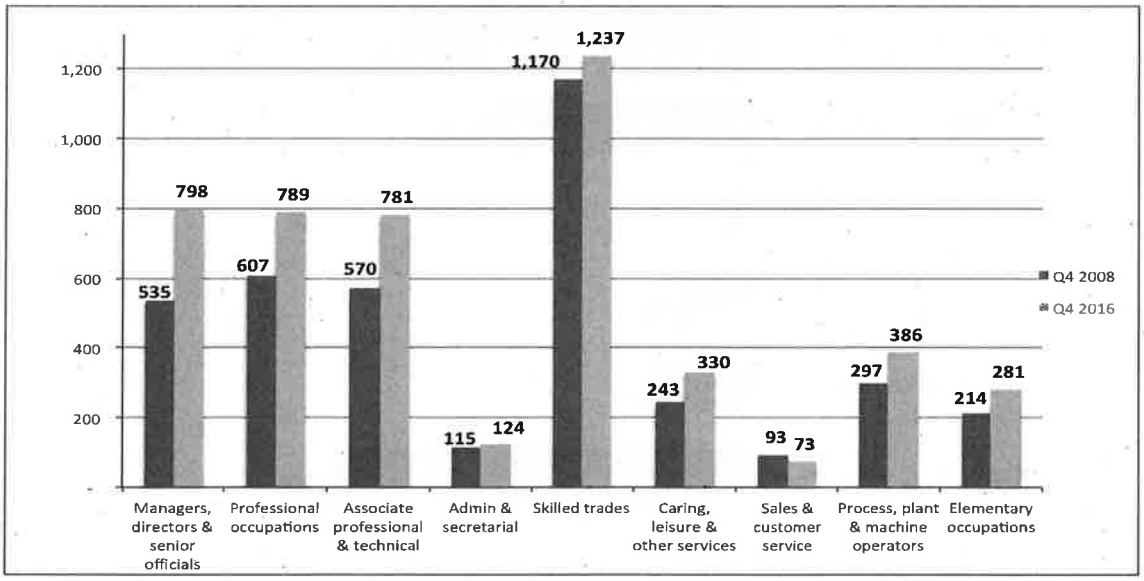
APPENDIX 4: data for payroll tax considerations

Figure 4.1: All self-employment, broken down by occupation, Q4 2016



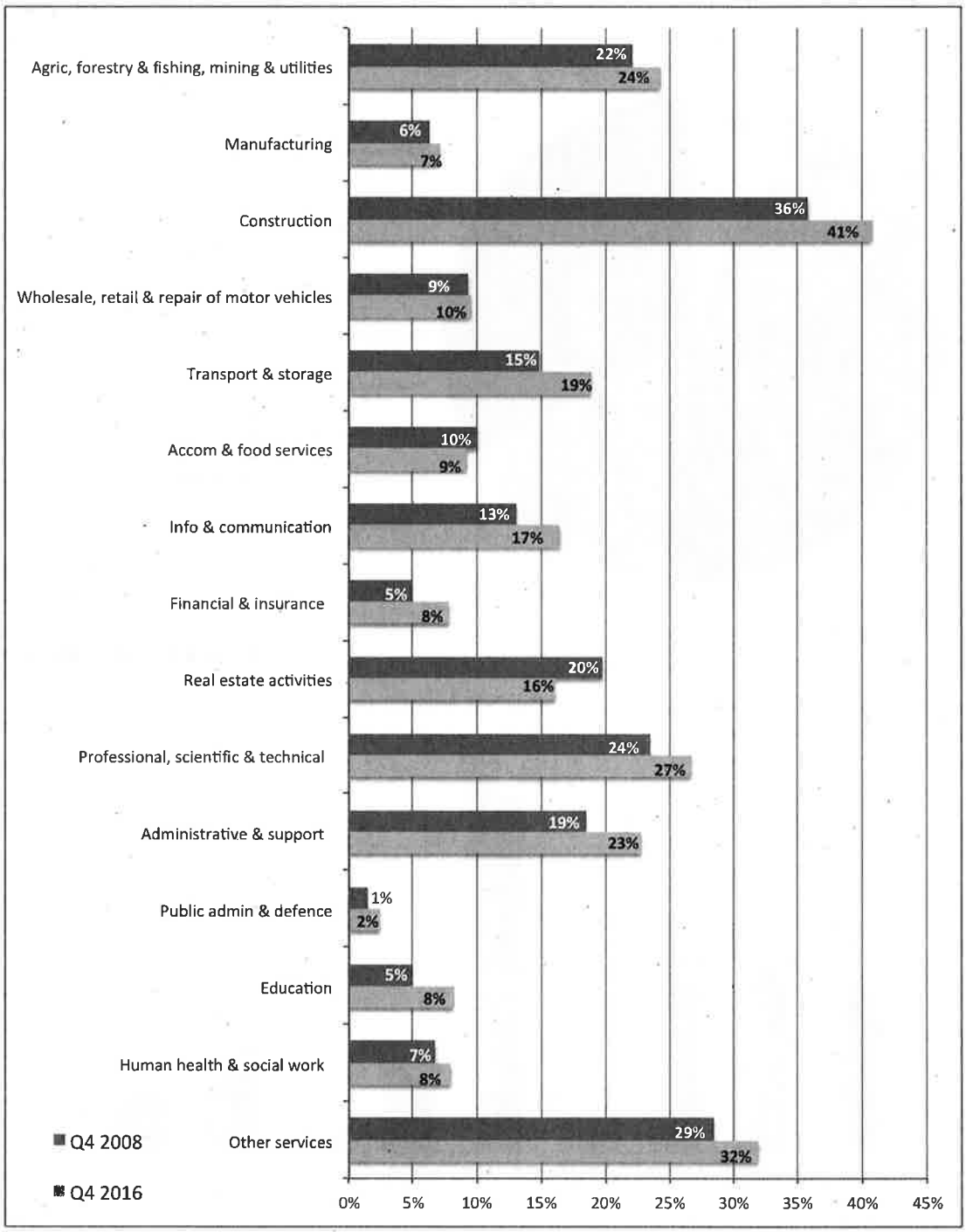
Source: FCSA analysis of ONS data

Figure 4.2: Self-employed numbers, by occupation, Q4 2008 and 2016



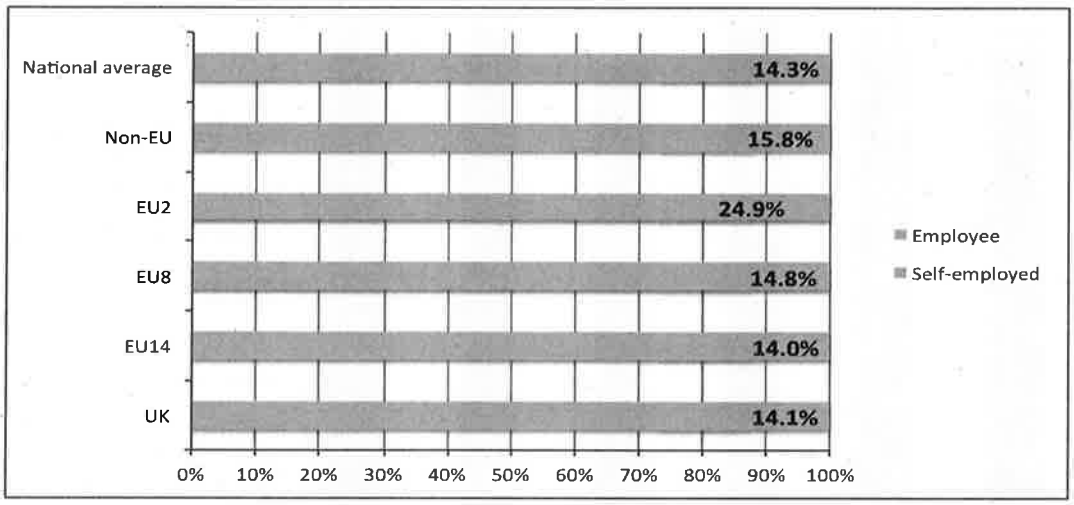
Source: FCSA analysis of ONS data

Figure 4.3: Self-employed as a percentage of the total number of employed and self-employed within an industry, Q4 2008 and 2016



Source: FCSA analysis of ONS data

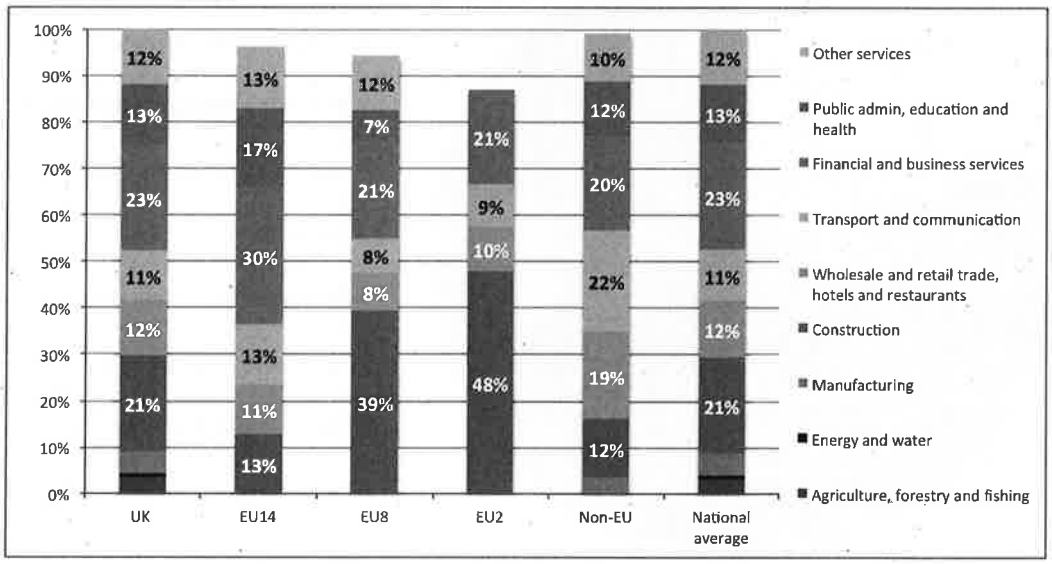
Figure 4.4: The proportion of employment / self-employment, by nationality group, 2016



Source: FCSA analysis of ONS data

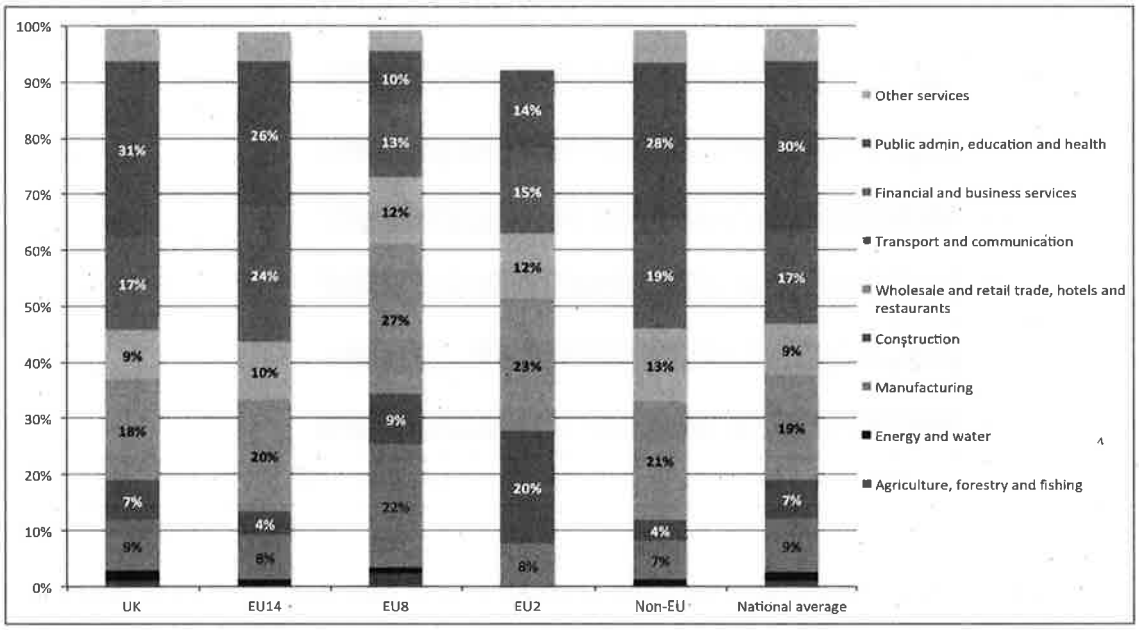
- EU14 are countries who were members of the EU prior to 2004: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland (Republic of), Italy, Luxembourg, the Netherlands, Portugal, Spain and Sweden.
- EU8 are countries who joined the EU January 2004: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia.
- EU2 is Bulgaria and Romania, who joined the EU in January 2007

Figure 4.5: The sectors in which the self-employed are engaged, by nationality group, 2016



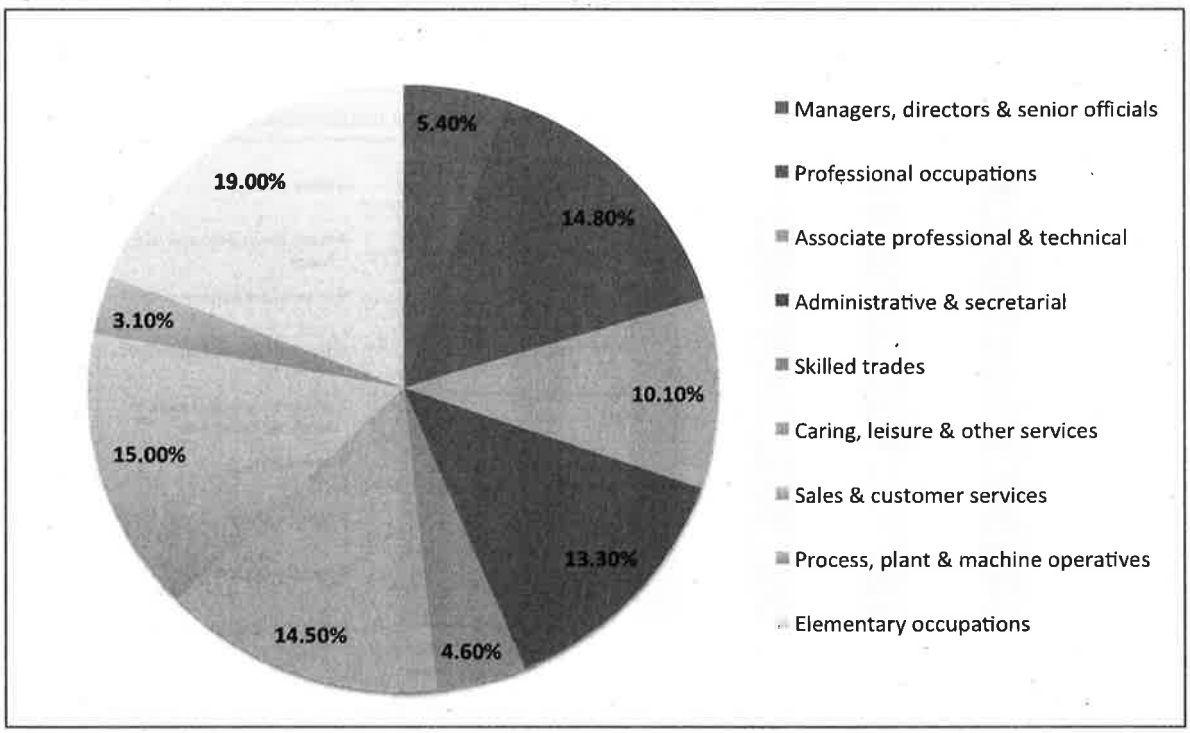
Source: FCSA analysis of ONS data. NB: some totals do not sum to 100% due to disclosure controls

Figure 4.6: Total employment by sector, by nationality group, 2016



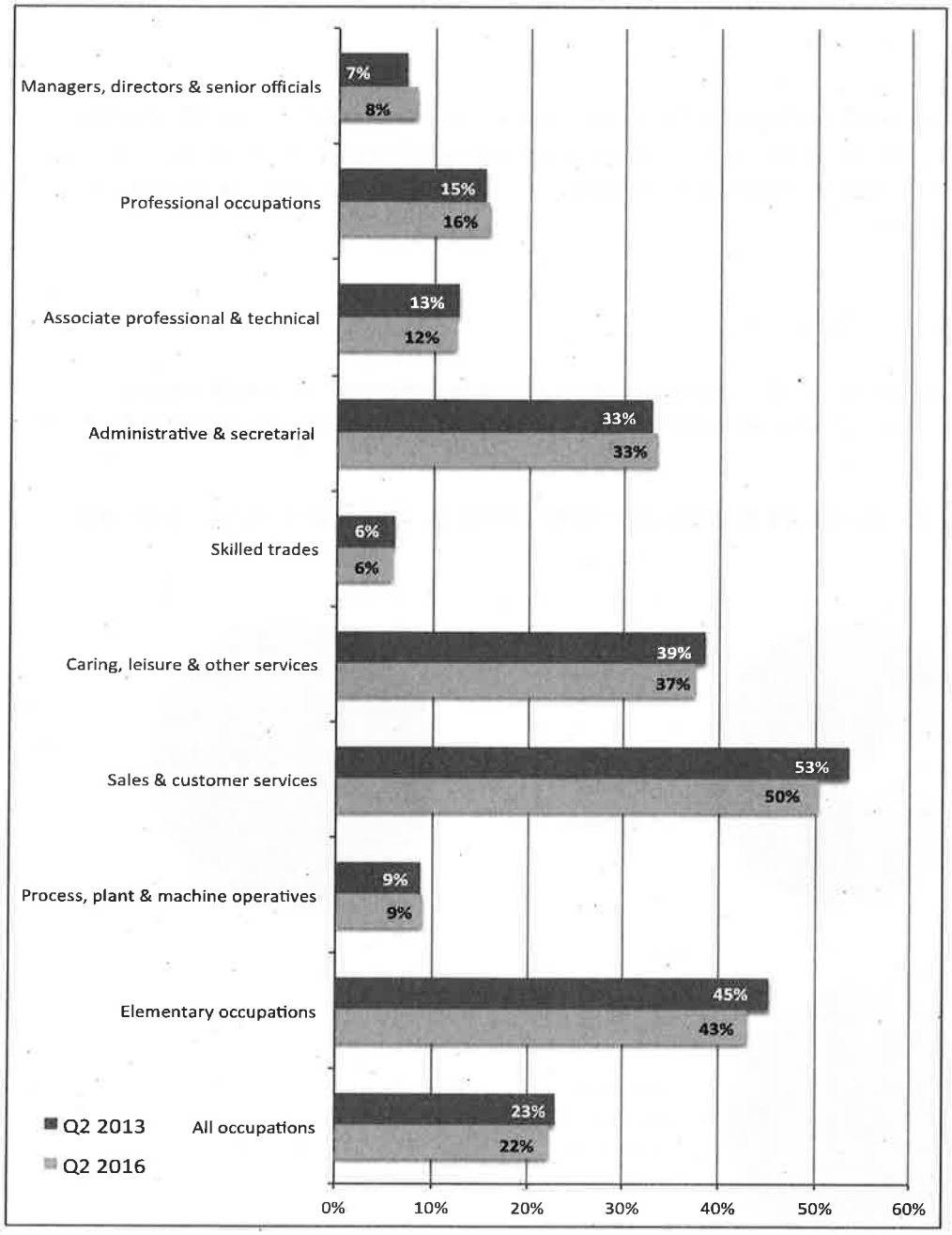
Source: FCSA analysis of ONS data. NB: some totals do not sum to 100% due to disclosure controls

Figure 4.7: All part-time employment, broken down by occupation, Q4 2016



Source: FCSA analysis of ONS data

Figure 4.8: The proportion of the total workforce, by occupation, that is engaged on a part-time employee basis, Q2 2013 and 2016



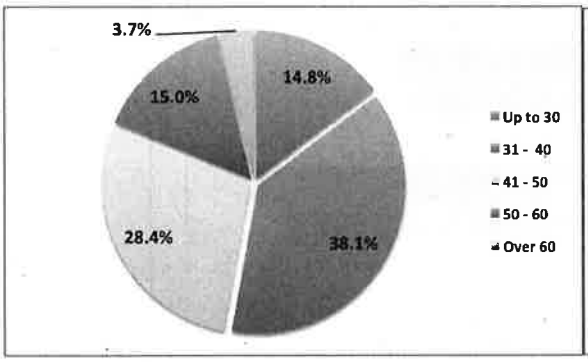
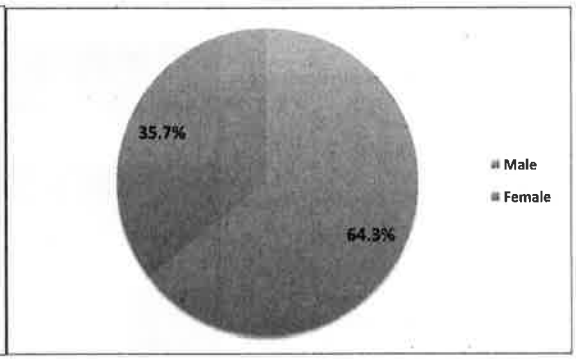
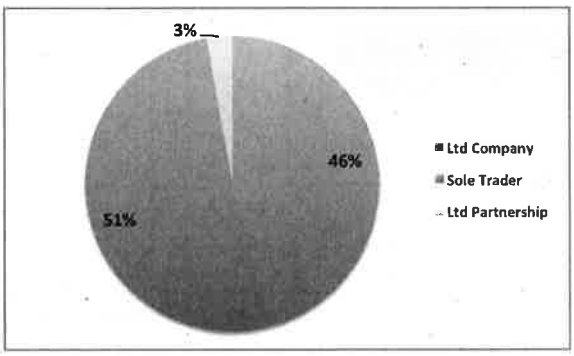
Source: FCSA analysis of ONS data

APPENDIX 5: Survey Methodology

Umbrella Employment Survey

The FCSA ran an online survey in April 2017, from which it received responses from 38 Umbrella companies. The combined number of employees of this group of companies, in February 2017, was 125,000. For the question responses quoted within this submission, the employee sample was analysed was 62,500.

FCSA / FreeAgent Self-Employment Survey

The FCSA ran an online survey in conjunction with accounting software company FreeAgent (www.freeagent.com) in May 2017, from which it received 898 responses from owners of their own business.

By way of the age, gender and business type profiles, there was good representation across the spectrum: