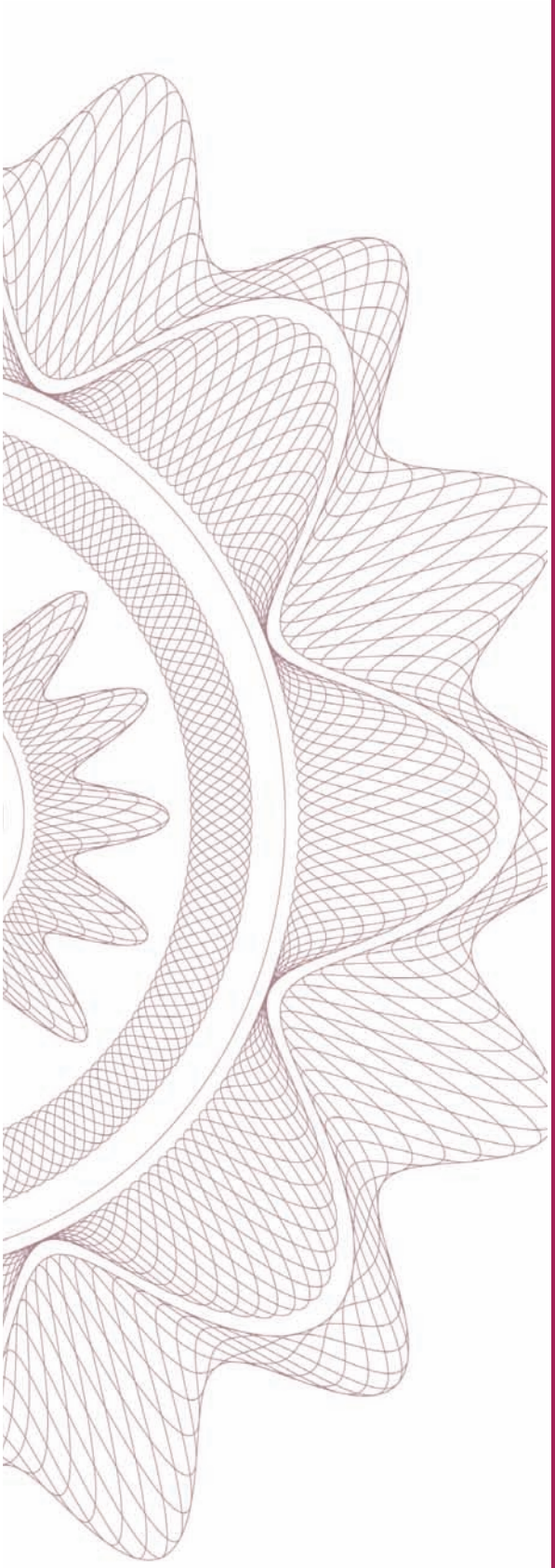
PROFESSIONAL PASSPORT

Professional Passport



Response to HMRC discussion document

Employment Intermediaries: Temporary workers - Relief for travel and subsistence

10th February 2015

CONTENTS

Contents

PROFESSIONAL PASSPORT

ABOUT US

PROFESSIONAL PASSPORT

About Us
Professional Passport

Professional Passport is a specialist organisation that works across all sectors of the temporary workers market providing support and direction to companies seeking to operate with robust compliance.

Since our formation in 2007, we have looked to raise the levels of compliance across the temporary workers market both in awareness and application.

Our work with end clients, recruitment companies, service providers and contractors provides us with a unique view and understanding of the market.

An important part of the work we do is to formally assess the processes and procedures of services providers operating in the umbrella and accountancy services sector.

Where a provider successfully meets our required standards, confirmed by an extended visit to their offices to fully evidence the correct operational processes in application, they become an 'Approved Provider' of Professional Passport and their name is added to our Approved Provider listings.

Whilst there are a number of organisations that offer compliance assessments Professional Passport remains the most widely accepted, recognised and trusted assessment of provider compliance in the market.

Our current Approved Provider listings are made up of 22 umbrella providers, 3 CIS gross status umbrella providers and 18 accountancy service providers; representing more providers than any other available standard.

Professional Passport also works closely with recruitment sector trade bodies APSCo, the Association of Professional Staffing Companies, and TEAM, The Employment Agents Movement.

APSCo and TEAM require any service provider, who wishes to promote their services to their recruitment company membership, to have undergone and passed one of a number of compliance assessments before they will be accepted as 'affiliate members'. Professional Passport assess more of the service providers for these bodies than the other offerings put together.

In recent years we have seen a dramatic increase in the numbers of payment intermediaries coming in to the market, many looking to offer an umbrella service.

The knowledge and application of the required operational processes and procedures was low as there was no trusted reference points for those seeking to operate compliantly. For this reason we wrote The Compliant Umbrella Providers Operational Handbook. This manual was designed to create a benchmark standard for compliance and has been invaluable in raising the understanding and application of compliance in the sector.

We have supplied a number of copies of this book to HMRC officials and we would happily supply further copies if HM Treasury would find it of use in this review.

About Us

Professional Passport

In setting the standards across the sector Professional Passport has taken a clear and transparent approach. We publish regular Newsletters to support this approach.

Provider Newsletters
Our provider newsletter is available to all our approved providers and clearly sets out our views and position on new emerging models entering the market.

It also updates the providers on any required changes to operational processes and procedures to ensure ongoing compliance.

Agency Newsletters
Our agency newsletters are designed to inform recruiters on emerging models and associated risks as well as update on new legislation impacting the sector.

These are subscribed to by over 2,000 individuals.

Contractor Newsletters
These are aimed at our contractor membership and are sent to over 12,000 subscribers.

They are designed to inform and educate contractors on the available structures and associated risks.

Our newsletters and guides help support our clear and transparent approach to compliance and assist workers in making informed choices.

Professional Passport was the first of the compliance assessment standards to refuse to assess any provider who operated, or had any form of association to, Pay Day by Pay Day models, prior to HMRC's statement expressing their views.

We were also the first to refuse to assess any provider offering a self-employed payment intermediary solution in the general contracting marketplace; long before HMRC published the consultation paper.

We refused to assess any organisation seeking to use contrived LLP structures within their service offerings, once again before these rules were changed.

We have never worked with any provider offering tax avoidance or offshore arrangements.

The consistency and clarity of messages has resulted in us becoming the trusted compliance assessment of choice for hundreds of recruitment companies.

These recruitment companies rely upon our Approved Providers for the delivery of services to the appropriate workers. This results in a commercial advantage to our approved providers for demonstrating high levels of compliance.

We have worked closely with HMRC throughout in both highlighting, informing and addressing some of the issues that have emerged in the market.

PROFESSIONAL PASSPORT

About Us

Professional Passport

We are now seeing end client awareness rising on the issue of supply chain compliance and we have a number of end clients that insist their recruitment partners can only accept workers through companies that have passed the Professional Passport compliance assessment.

Professional Passport has pro-actively campaigned since formation for a more level playing field for the providers that seek to operate compliantly as in many cases they have consistently operated at a commercial disadvantage.

This has included issues such as:

- Tax Avoidance
- Offshore Payment Intermediaries
- Pay Day by Pay Day
- Dispensations
- Expenses
- Margin and Fee Deductions
- IR35

Whilst progress has been made in some areas there is still much to do and we welcome any opportunity to become involved in active discussions and debates that are designed to deliver a more level playing field in the market.

Should you require any clarification on our thoughts contained within this response document, or wish to discuss any of the ideas in more detail, please feel free to contact us.

PROFESSIONAL PASSPORT

Executive Summary

Executive Summary

The Discussion Document is correct in identifying that an issue exists around the claiming of travel and subsistence expenses to a temporary place of work as well as there being issues around the classification of the workplace's status.

We would however take issue with a number of the points contained within the Discussion Document:

- The data used is historic and fails to recognise changes that have occurred in the market following the introduction of the Offshore Employment Intermediaries Legislation and the Onshore Employment Intermediaries Legislation.
    - The reduction in use of self-employment intermediaries in the general contracting marketplace.
    - A polarisation of the market into:

    i. Compliant payment intermediaries operating at the high end of the market working with recruitment companies who operate preferred supplier listings.

    ii. Non complaint payment intermediaries targeting low paid workers and gaining access to the market through high financial incentives to the recruitment companies operating in these sectors.
- The Discussion Document also fails to recognise the significant changes in the market since the original T&S review was carried out in 2008.
    - The increase in workers who consider contracting as a way of life and seek to build a long term career in contracting.
- The suggestion that the issue centres around the use of OACs and the umbrella providers is too simplistic and fails to identify, and address, the route cause of the problem.
    - Traditional 'Agency Workers' wholesale movement to payment intermediaries that allow the claiming of significant levels of expenses.

The resulting conclusions not only fail to address this route cause but suggest a 'one size fits all' solution failing to recognise the complex make up and structure within the market. This approach will damage the market and in certain sectors could drive specialist work away from the UK.

The result of this approach will be to create more unfairness within the market and it is also likely to provide further commercial advantages to non-compliant solutions.

PROFESSIONAL PASSPORT

Executive Summary

The Discussion Document claims that the proposed actions will result in generating £400m of tax revenues to the Exchequer; these claims are wrong and fail to consider the reaction that will happen in the market should the new rules are implemented.

- The rules deliver £400m if **all** affected workers are assessed under PAYE, which is the most unlikely outcome.

- This ignores the move of workers from compliant umbrella provider to PSC.

  We would estimate that around 50% of workers currently operating in compliant umbrella providers would move to a PSC as a direct result of the proposed rules.

  This move of workers will result in a loss of £600m, greater than the predicted gain and it would also impact the predicted gain reducing it down to £200m delivering a net loss in tax revenues of £400m.

This represents the best outcome as it too fails to consider other emerging structures. If we then bring this additional movement of workers in to the equation it further reducers the predicted returns.

- The workers that would move to new emerging structures would result in a further loss of tax revenues estimated to be in the region of £100m resulting in an overall tax loss of £500m.

There are already solutions in the market that do not utilise OACs. We would predict an increase in the availability, and use, of these arrangements if the proposed targeting of solutions that operate with OACs was followed through. This will significantly impact, as we have shown above, the forecast on anticipated returns made within the document.

These emerging solutions also seek to circumvent much of the legislation across the sector that provides employment levels of protection to the workers.

We would go further and suggest that the proposed action is more likely to result in an overall loss in tax revenues of £500m if enacted.

The suggested outcomes will produce a more 'unlevel playing field' contrary to the objectives of moving towards a 'more level playing field'.

PROFESSIONAL PASSPORT

Executive Summary

The problem, as we have identified, that needs to be addressed

As we illustrate through this response the issue at the centre of the problem is the wholesale movement of 'Agency Workers' into payment intermediary structures that fail to apply the existing rules as intended.

These solutions, primarily targeting the lower paid workers, has resulted in workers previously unable to make expense claims now being encouraged to make claims and significantly reduce their tax liabilities.

Many of the expense claims we see are exaggerated and unchecked resulting in disproportionately high claims on lower incomes.

This also allows the promoters of such arrangements to mask the charges associated with them and provides them with significant revenue streams.

We have reached this conclusion based on a number of key factors:

- The significant increases in enquiries from recruitment companies to Professional Passport seeking our views on moving their 'Agency Workers' to these solutions.
- The numbers of companies that now offer these solutions has increased dramatically and as a result of their relationships with recruitment companies they are now expanding their offerings across all workers within recruitment companies and creating real commercial difficulties for complaint providers. It should also be noted that many of these models do not use OACs.
- The increased media coverage on the schemes designed specifically for low paid workers.
- HMRC's recognition of the issue by releasing statements in an attempt to stop their market penetration.

This wholesale move has also been fuelled by a number of factors that include:

- Large financial incentives offered to recruitment companies to move these workers turning a cost of running a payroll in to a significant profit revenue stream.
- The removal of any employment liabilities or associated costs of employment from recruitment companies.
- A failure in recent Onshore Employment Intermediaries Legislation to catch these solutions within the liability clauses.
- A lack of visible compliance enforcement over three and a half years; the first point that HMRC issued their statements confirming that in their opinion the Pay Day by Pay Day solutions were not compliant.
- A lack of clarity on the application of s339 ITEPA 2003 limited purpose and duration test for temporary workplace status.

PROFESSIONAL PASSPORT

Executive Summary

This wholesale move of low paid workers is not as a result of any action from compliant umbrella providers as they are unable to deal with lower paid workers.

The use of OACs does not remove the need for the tests on workplace status and therefore cannot be the issue.

Compliant and responsibly run umbrella providers apply these workplace tests and where a workplace fails the tests the workers are prevented from making T&S expense claims.

Our response considers these points in detail and we believe that our recommendations would provide a framework to eradicate this behaviour from the market.

These proposed actions would also result in the right workers being placed in the right structure based on their individual circumstances and in turn create a level playing field as described in the Discussion Document.

Ensuring the workers are in the correct structure, with the rules applied as intended, protects tax revenues. The significant numbers that would return back in to an 'agency worker' category with the resulting loss of the exaggerated expenses will provide significant additional tax revenues.

These recommendations will also not impact workers currently working correctly through the compliant umbrella companies and therefore we would not expect any movement away from these structures. This protects the existing tax revenues from the umbrella workers as they will not be seeking alternative structures that would otherwise have resulted in the reduction of tax revenues.

The comparisons between the returns to workers within the various categories would become more representative of their true underlying circumstances and therefore more relevant and aligned.

We also believe that the recommendations will provide a strong framework to support and encourage the correct compliant behaviour across all sectors of the market.

The recommendations also ensure the correct risk reward balance is in place to apply significant penalties to those that systemically fail to apply the rules as intended.

HISTORY

LEARNING FROM THE PAST

History
Learning from the past

The first of the major changes that influenced the markets structure happened with S44-47 of ITEPA; prior to the introduction of this many workers operating through recruitment companies were self-employed.

Almost overnight all workers operating through recruitment companies, except those operating in construction, were forced to adopt an incorporated structure or required to move onto the recruitment company payroll as the recruitment companies were not prepared to take the risk of becoming liable for the contractors tax.

Contractors who were now 'forced' to incorporate found that having their own limited company resulted in a wide range of benefits which, at that time, included the ability to pay a low salary and make pension contributions equal to the salary, as well as remunerating themselves through a mix of salary and dividends, which in some instances could result in a reduction in the overall tax that was paid.

During the mid to late 1990's there was a significant growth in contracting, particularly in the IT sector as a result of fears of a 'Millennium Bug' affecting all computers. At this time there was evidence of workers leaving jobs on Friday and returning on Monday as a contractor, sitting at the same desk and doing the same role, all be it now as a contractor, through a recruitment company.

There were a number of primary factors that drove this which included the rising cost of employment and the associated employee benefits as well as company valuations being influenced by efficiency which included an analysis of the value derived by employee.

Engaging contractors through recruitment companies allowed a company to save significant costs associated with direct employment, and the worker was happy as they saw the move as an effective pay increase. Very few workers considered the additional benefits they were giving up as a result of the move such as pension rights etc.

This also assisted the company in looking more efficient potentially resulting in increased stock market valuations, as contractors were never included in head counts and therefore increased the efficiency calculations based on value by employee..

As this new trend gathered pace the Government intervened with a Budget announcement in 1999 followed up by a Press Note:

"There has for some time been general concern about the hiring of individuals through their own service companies so that they can exploit the fiscal advantages offered by a corporate structure. It is possible for someone to leave work as an employee on a Friday, only to return the following Monday to do exactly the same job as an indirectly engaged 'consultant' paying substantially reduced tax and national insurance."

This resulted in the IR35 Legislation.

The introduction of this ambiguous legislation fuelled the growth of specialist providers of services to the contracting market.

HISTORY

LEARNING FROM THE PAST

New operating structures emerged ranging from tax avoidance solutions through to composites, managed service companies and umbrellas, as well as the traditional limited company offering. All of the models were designed to deliver the highest possible returns for the contractors.

The umbrella providers built, and marketed, their offering for those workers who were caught by IR35 and did not want the responsibility of running their own limited company.

Many of the other 'new offerings' looked to exploit loopholes in legislation to deliver tax advantages and increase the return to the contractor.

At the same time as these developments in the contracting market, the banking market was experiencing significant growth in their profits with senior executives receiving bonuses at levels never previously seen. In an attempt to maximise their executives' returns, banks were developing ways to pay these bonuses with the minimal amount of tax. Tax avoidance at this time was commonplace and becoming more widespread and costly for HMRC.Many of these arrangements originally developed for the Banking Sector were now emerging as offerings to contractors.

As a result in December 2004 announcements were made in the Pre Budget that were designed to kill off the tax avoidance market. Many Governments across the world were introducing similar legislation as they too were experiencing the same issues. From this point the Governments attitude towards tax avoidance became very similar to tax evasion.

This move, whilst not directly aimed at the contracting market, had a significant impact and those previously offering tax avoidance solutions had to change.

This change fuelled further growth across the composite and managed service company providers.

From 2005, as a result of these announcements, the tax avoidance market for contractors was almost nonexistent.

2006 saw the introduction of DOTAS with companies marketing any tax avoidance schemes required to register the details by the October of that year. With significant penalties and fines for failure to do so the vast majority complied.

Analysis carried out by HMRC on the returns found that 'Restricted Share Schemes' were the most prevalent vehicle in delivering a mass marketable tax avoidance arrangement. The Pre Budget Statement of 2006 dealt with this:

"Legislation, effective from today, will also be introduced to tackle a number of artificial schemes used by companies to avoid tax that have been notified under the disclosure regulations. The Government is also removing the public quotation exemption from the Controlled Foreign Companies regime to prevent specific avoidance."

This was hoped to be the final nail in the coffin for mass marketed tax avoidance solutions.

HISTORY

LEARNING FROM THE PAST

In early 2006 the Government also recognised the growth in the specialist provider market offering solutions to contractors and expressed concerns over compliance within this market. This lead to the announcement in the 2006 Pre Budget of a new piece of legislation specifically aimed at the specialist provider market; the MSC Legislation.

"The Government is today announcing action to tackle Managed Service Company schemes and is publishing a document on the measures and consulting on draft legislation to implement them. Personal Service Companies will not be within the scope of these measures with the Intermediaries legislation remaining in place as at present."

This new legislation was to be supported by debt transfer rules removing all protection from contractors, providers and potentially recruitment companies and making assessed debts personal liabilities.

Debt Transfer was seen as an important step as on many occasions when HMRC took action to recover lost tax revenues against, what they perceived, as non compliant providers they would find the providers had closed the business and there were no assets. What made this worse in many cases was those providers would then re-emerge overnight and continue as if nothing had happened often making claims of robust compliance.

This legislation came into effect in April 2007 and created a significantly changed market with far fewer variations between providers' models. The market initially polarised into two clear models;

- Umbrella
- Accountancy Services

At the time of introduction many commentators and respondents to the MSC Consultation highlighted potential consequences that the change could drive. One of the issues raised by many was a fear that this could drive a growth in offshore provider solutions specifically aimed at the sector. Assurances were made that this would not happen as a result of the new focus on cracking down on tax avoidance.

As 2007 progressed under this new MSC Legislation a re-emergence of offshore tax avoidance models began.

These models, being based offshore, gave the providers protection from attack by HMRC but left the contractors exposed. In general contractors were unaware of true levels of risk as many of the promoters of these solutions provided false assurances to the contractors.

At the same time recruitment companies had become concerned that giving any advice to contractors on operating structures could leave them exposed to the risk of debts under the new legislation. As a direct result of these concerns the traditional preferred supplier listings offered by many recruitment companies were withdrawn and contractors were left to make their own decisions on operating structures and providers. This further assisted the growth of these new offshore models.

History

Learning from the past

Whilst it was clear that umbrellas were not within the scope of the MSC legislation, statements confirming this were made at the time as well as a confirmation within the guidance note that sat alongside the legislation, what was less clear was the real definition of an umbrella.

Many emerging models labelled themselves as an umbrella in an attempt to give reassurances to recruitment companies. Close examination identified that they did not meet the requirements of HMRC's understanding of a compliant umbrella. This resulted in further confusion and uncertainty.

With umbrella providers falling outside the legislation this lead to a significant increase in the number of umbrella companies. A number of these companies failed to grasp the complexity involved in operating a genuine umbrella model compliantly.

Umbrella marketing across the whole sector was focused almost exclusively on expenses and which umbrella company allowed the contractor to claim the most. This was as a direct result of HMRC issuing differing levels of expense dispensations in the market creating this unlevel playing field and providing an unfair advantage for some resulting in the focus on expenses as a differentiator.

This marketing approach resulted in the Government announcing in 2008 that is was looking at the market more closely and the release of the consultation paper Travel Expenses and the Umbrella Market.

Following a review the Government confirmed that no action would be taken at that time but they would keep a watching brief on the market and developments.

In the Government's response they confirmed:

"HM Revenue and Customs will refocus its efforts to ensure that the current regime is properly applied."

Subsequent to this we have seen HMRC looking to provide standard levels of expense dispensations to all umbrella providers who apply, removing this anomaly.

A specific office has also been established with specialist knowledge of the sector to deal with any requests for dispensations from the sector and ensures other factors such as appropriate contracts and conditions exist before agreeing to the dispensation.

In October 2011 The Agency Workers Regulations came in to effect. These regulations were designed to provide workers with the entitlement to the same, or no less favourable, treatment for basic employment and working conditions after a qualifying period of 12 weeks.

These new regulations were introduced in a period where there was also a significant economic downturn and the combination of these 2 factors drove the resulting behaviours.

Recruitment companies found that it was easier to build relationships with a small selected number of providers in order to develop processes and procedures that would assist them in meeting the obligations of the regulations; a return to the preferred supplier lists.

HISTORY

LEARNING FROM THE PAST

In return for being listed providers were asked to pay a 'commission' on each time sheet processed for the workers. Whilst this had been in place previously it was at much lower levels. Where a recruitment company operated a self-billing agreement with the umbrella company this reduced the administration for the umbrella. The recruitment company then looked for a commercial level of compensation for delivering this reduction in the umbrella administration costs. Many of these early agreements were at levels around £2.50 per time sheet.

These new arrangements took them from a commercially justifiable level as compensation to a way that recruitment companies could generate significant levels of income and profit to the company. We regularly now see levels of between £10 to £15.

This period also saw the first signs of self-employment re-entering the general contracting market as many believed that a self-employed worker fell outside these new agency regulations. To prevent the agency becoming liable for the workers tax a payment intermediary using an incorporated structure fronted these arrangements.

There was also the growth of other models that were specifically designed to provide high returns to lower paid workers who were traditionally engaged through the agency payroll as 'agency workers'.

These new models created ways the worker could reduce tax through the use of expenses. These workers previously were unable to operate through any compliant umbrella provider. These structures are now commonly referred to as Pay Day by Pay Day.

July 2011 saw HMRC first publish a statement confirming that in their view these arrangements operated outside the rules and, in their opinion, were not compliant.

Tax avoidance structures continued to grow and gain traction in the market, as predicted by many respondents to the MSC Legislation consultation.

With the offshore providers now being so prominent across the whole market the BBC in November 2011 highlighted the growing trend on the use of tax avoidance schemes with a programme highlighting the thousands of state school teachers that were using offshore arrangements and the resulting loss to the Exchequer.

In 2013 the Government announced a consultation 'Offshore employment intermediaries' in an attempt to stop this abuse. The process resulted in the introduction of the new Offshore Employment Intermediaries Legislation in April 2014.

During the run up to its introduction it became clear that many offshore providers were looking to use a 'self-employed' payment intermediary route as a way to circumvent rules and this posed a significant risk to tax revenues. Unlike the self-employed CIS arrangements where workers had to formally register as self-employed and this registration was checked as part of the process these solutions had no such requirements and there was no way for HMRC to easily identify the workers using these arrangements or their status. Many of the providers of these arrangements were making little, if any, checks to ensure workers had registered as self-employed.

This resulted in a further piece of legislation: Onshore Employment Intermediaries: False Self-Employment.

The common, and most important, feature across both these pieces of legislation was that a recruitment company could now be held liable for any tax losses resulting.

The second piece of legislation, The Onshore Employment Intermediaries Legislation, included a significant change to how workers operating in the construction sector could arrange their affairs.

Many who responded to the consultation accepted the concept for the general contracting market place but questioned whether the change in the construction sector was appropriate and suggested a deeper review and understanding before implementation in this sector. The Government decided to press ahead with all the proposals.

The outcome in the general contracting market has been a significant drop in the use of offshore arrangements to the point that they are few and far between as well as the removal of almost all self-employed payment intermediary models as previously identified.

The construction sector has not been as smooth.

The basic issue was that historically a worker operating in the sector as a self-employed individual was paid at a rate known as the limited company rate. This rate is higher than the rate offered to a worker operating on the agency payroll as it includes compensation for additional costs such as tax and national insurance as well as holiday pay. In the case of agency payroll workers these were costs to the recruitment company hence the lower rate offered.

The changes resulted in many construction workers being forced to use payment intermediaries, which carry charges for their use. As the worker was already receiving the limited company rate there was no uplift to the rate to compensate them for the additional costs they would now have to incur.

Many recruitment companies will now not engage any self-employed worker in the construction sector, as they are concerned over potential liabilities. This has resulted in many workers now gaining 'false employment'. The worker has also found a reduction their take home pay which has led to the dissatisfaction and complaints about umbrella providers.

During the same period the Pay Day by Pay Day models were significantly increasing their market share. The new liabilities clauses failed to catch their offerings and so represented little risk to recruitment companies who used them.

The providers of these arrangements were offering time sheet commissions at levels that compliant providers were unable, or unwilling, to match which proved a further attraction to the recruitment companies.

As these models were aimed at the lower paid workers they also provided many recruitment companies with the ability to do away with the 'agency worker' and their PAYE schemes and push workers in to these structures.

This turned a cost centre for a recruitment company, running a payroll for workers, in to a significant profit generating process.

HISTORY

LEARNING FROM THE PAST

The result is that there has been a significant decline in the numbers of recruitment companies that continue to offer workers a PAYE rate as well as a limited company rate and so transparency has been lost.

Over the past 15 years the market has matured significantly and contracting has now become a common way of working. Many schools now discuss 'Portfolio' employment, what we refer to as contracting, as part of their careers advice to students.

The days of workers leaving on Friday and returning to do the same job on Monday are no longer as prevalent and there is an established contractor workforce operating across the UK.

Skilled contractors are mobile and follow the work often travelling across the whole UK and seeking temporary accommodation for the duration of these contracts.

Predictions from all leading business groups confirm that it is their belief that the temporary workers market will continue to grow as it supports the fast changing needs of the modern business, we agree with these views.

Ensuring the correct rules are in place is a critical step in maintaining the UK's position as a market leader in this area, with all the resulting benefits.

The learning we can take from the past is:

- The market is growing fast and this is expected to continue.
- The market always reacts to any change in the rules.
- The market adapts and changes at pace.
- Recruitment companies provide, and control, access for payment intermediaries to the workers market.
- Both financial incentives and liabilities drive the behaviours in the market.
- Workers fail to grasp the complexity of many of the arrangements on offer.
- Visible compliance enforcement is essential in developing an orderly marketplace.

Learning
What we can take from other sectors

We believe that the Financial Services Sector provides some good comparator examples of measures that can be put in place to underpin an effective compliance culture.

We do understand that the Financial Services Sector is regulated and the Payment Intermediary Sector is not. Whilst arguments can be made for the need for some form of regulation in the Payment Intermediaries Sector we also accept that this is costly and takes a considerable time to implement. As a result we do not believe regulation of the Payment Intermediaries Sector at this time is a viable approach. A growing number in the sector are also demonstrating a willingness to 'self-regulate' with a growing number of organisations seeking to meet our compliance review standards.

If, for the purposes of this example, we refer to the 'Regulator' as the 'Enforcer' of the rules this then creates a direct comparison. HMRC are effectively the enforcer of the rules across the payment intermediaries' marketplace as many of the rules applying to the sector are tax based.

When the financial services sector first became regulated there were two groups that offered advice to individuals:

- Tied Agents
- Independent Financial Advisers [IFA]

Tied agents typically operated through the life companies. The life companies were building these sales forces and in many cases their numbers of representatives amounted to thousands of individuals. [Comparable to Payment Intermediaries in The Temporary Workers Market]

The IFA sector was almost the exact opposite with thousands of small companies operating across the sector. [Comparable to PSCs in The Temporary Workers Market]

Very quickly it emerged that effective compliance enforcement could be achieved in the tied agent sector as one visit to a life company to examine and review its processes and procedures ensured the compliance of thousands of individual representatives. The IFA sector proved far more difficult and costly with such a diverse population.

As a result the enforcement of compliance across IFAs was generally seen as significantly weaker than that of the tied agents.

The sector then spent many years of transition resulting in a new structure where all individuals providing financial advice where within large structures; the life company representatives remained and the small IFAs were moved in to 'networks' [specialist accountancy service providers in The Temporary Workers Market]. These networks became responsible for the compliance of their member companies and put checks in place to ensure processes were followed.

From an enforcement perspective the enforcer now had a relatively small number of large groups that it had to ensure operated with the correct processes and procedures as opposed to the diverse population.

LEARNING

WHAT WE CAN TAKE FROM OTHER SECTORS

Provision of financial advice to individuals is subject to one of the most stringent set of rules designed to protect the consumer and yet there have still been many scandals across the sector, the latest being the inappropriate selling of Payment Protection Plans. This proves that rules alone will not result in compliance.

However with the introduction of Directors personal liabilities and large group structures where compliance breaches have been found there are large entities that can be held accountable.

Furthermore with the name and shame rules now in place to name companies where systemic failings are found this too has provided a further deterrent.

The learning that is transferrable to the temporary workers market is:

- The rules alone do not create compliance they create the framework for compliance. The rules have to be supported by an effective enforcement regime.

  In the temporary workers market we have clear evidence in the recent case of Pay Day by Pay Day models that even after HMRC issued statements that the arrangements were not considered compliant they continue to grow and provide their solutions to thousands of workers as a result of no visible enforcement.

  As shown in Financial Services and many examples in the history of the temporary workers market rules alone do not achieve compliance they merely create the framework for enforcement. Rules that are not supported by an effective compliance regime quickly become ineffective and widely ignored.

- Effective enforcement across a wide diverse population is difficult and costly and encouraging large group structures, in a controlled way and within well defined parameters, allows the compliance enforcement of thousands through a review of the lead provider company.

  In the case of the temporary workers market we have IR35. The tests within IR35 have to be enforced across a wide and diverse population and are difficult, time consuming and expensive to enforce. Current enforcement is checking around 0.2% of the market. This low level of compliance enforcement does not create or encourage compliance to the rules.

  Furthermore we have a group of payment intermediaries, current estimates suggest somewhere in the region of 250, providing solutions to thousands of workers and yet current compliance enforcement is ineffective as a significant proportion of these continue to offer solutions that HMRC has publically stated as non-compliant nearly 4 years after the initial statement.

  If the enforcer is unable to effectively apply compliance across a group of 250 large provider companies then it follows that making this group more diverse will result in weakened compliance enforcement in the market.

LEARNING

WHAT WE CAN TAKE FROM OTHER SECTORS

- Public name and shame where systemic breaches occur is a key aspect of any compliance enforcement strategy.

  HMRC when challenged on compliance enforcement often claim that they are active but prevented from commenting. This results in a market perception of lack of enforcement, as many of the non-compliant providers appear to continue offering their solutions unchecked often many years after HMRC has declared the offering to be non-compliant.

  If systemic failings resulting in non-compliance remains hidden to the public view, even when discovered by HMRC, then an important element, and deterrent, in compliance enforcement is lost.

- Corporate and personal liabilities drive behaviour change.

  This proved very effective with the introduction of Debt Transfer within The Managed Service Company Legislation and has had a significant impact on the providers operating processes and procedures in that sector.

  The liabilities placed on recruitment companies within the Offshore Employment Intermediaries Legislation and the Onshore Employment Intermediaries Legislation has also proved very effective in reducing the numbers of offshore providers as well as moving the whole CIS sector across to 'employed' arrangements even though the market generally disagreed with this move.

In summary we believe that the learning derived from The Financial Services Sector supports a number of conclusions:

- Rules only create the framework for compliance.
- Effective enforcement of the rules is a mix of a number of factors that together create the correct risk and reward balance.
- Large organisations engaging many workers creates a more robust and effective compliance enforcement and when supported by the right rules can create a more orderly marketplace. A single visit to review the providers processes effectively ensures the compliance of all the individuals.
- Visibility of enforcement activity is essential.
- Systemic failings and outright abuse is subject to significant consequences including name and shame and liabilities; both corporate and personal.

Hard data

Understanding the real issues

Every business, and business analyst, understands the importance of fully analysing current and accurate data in successfully identifying a problem and then designing the appropriate solution to address that problem.

The data used to support the conclusions made in the discussion document we believe is too narrow and based on historical information.

The Discussion Document fails to fully appreciate the recent moves in the market as a result of the changes implemented in 2014 following the introduction of the offshore employment intermediaries legislation and the onshore employment intermediaries legislation.

Furthermore, the additional requests for data from those engaged in the discussions and round table events will not provide a fully rounded picture and therefore should not be relied upon in reaching conclusions.

Whilst many compliant umbrella companies may supply this information it will once again fail to highlight what we believe to be the underlying issue as the compliant umbrellas do not operate with low paid 'agency workers'.

Building conclusions based on incomplete data from such a narrow spectrum will ultimately result in the wrong conclusions being reached. As a result the predicted returns from the action are unlikely to materialise and we would suggest the overall position could be worsened.

This could also result in significant damage to the flexible workers market as well as the overall reduction in tax revenues collected, as new models will emerge to circumvent the rules.

We challenge the claim that £400m of tax revenues will result from the suggested actions as it fails to recognise that workers will be encouraged to move to alternative solutions that could be more tax advantageous.

We are already aware of solutions being offered that would fall outside the suggested rules, as are HMRC, and this is likely to increase if the current suggestions are followed through.

As we have seen in the past the introduction of new rules to address the 'effect' creates a reaction in the market that then requires further legislative changes to address that reaction. Where rules are based at addressing the route 'cause' of the problem as opposed to the 'effect' these rules have been more effective and stood the test of time.

The core issue, as we believe, is the incorrect categorisation of workers driven by the increase in payment intermediaries offering solutions that allow the traditional 'agency worker' to move in to structures that encourages the use of expenses.

This core issue at the heart of the problem is further supported by recent TV coverage which all focused on low paid workers being exploited by these arrangements.

HARD DATA

UNDERSTANDING THE REAL ISSUES

Wrong perceptions of the whole sector are being created as a direct result of these arrangements targeting low paid workers. Many of the issues raised by Unions also centre on the issues with lower paid workers.

These low paid worker offerings market penetration have been accelerated by the financial incentives offered to recruitment companies to introduce their workers together with a failing in the Onshore Employment Intermediaries Legislation liabilities to catch such behaviour.

This growth has also come about due to the lack of visible enforcement in the past three and a half years since HMRC made their statement on Pay Day by Pay Day solutions.

This has created a perception of 'implied compliance' with many of the Pay Day by Pay Day providers citing this to put potential recruitment company clients minds at rest. Workers rarely understand the true underlying nature of these arrangements.

The questions that would identify the core issue, as we believe, have not been asked and there appears to be no appreciation, or a lack of appreciation, to the size and impact of this dynamic.

We are also aware that the data to analyse and fully support this issue is currently not readily available. We have reached our conclusions on this based on our experience in the market dealing with recruitment companies, providers and contractors.

Providers operating these types of non-compliant solutions, aimed at low paid workers, seek to operate out of the public view. By operating in the shadows this allows them to extend the period in which they can continue to offer the solutions and, at the same time, generate significant income levels for their directors.

We advocate an approach of adopting some 'quick wins' in the Budget of 2015 that would seek to redress the balance and protect tax revenues in the short term.

This action needs to be supported by a review of data provided as a result of the new reporting requirements that come in to effect in April 2015 with the first reports due by August 2015, similar to the review and follow up action resulting from the introduction of DOTAS in 2006.

The approach taken with the introduction of DOTAS in 2006 proved successful and the core areas were quickly identified and action was taken to prevent the main vehicles, resulting in many schemes closing overnight.

With recruitment companies required to provide a wide range of data on the workers they supply, this will provide clearly demonstrable and indisputable evidence on the impact the measures have had on the market together with a full picture of the structure of the market, including the numbers of workers contained within each of the categories:-

- Agency Worker on PAYE through the recruitment company
- Payment Intermediaries of all descriptions
- Own Limited Company

Hard Data

Understanding the real issues

We believe the data also removes the shadows that the non-compliant seeks to operate within and a clear and full appreciation on the make up and segmentation within the payment intermediaries sector will become apparent.

As a result the data will also be able to clearly identify any further actions that maybe required in achieving a level playing field and ensuring the rules are applied as intended.

We believe that there is a significant underestimation of the numbers of providers, and workers, engaged through those providers that are operating outside of the rules. This underestimation is resulting in the wrong conclusions and incorrect focus to the discussion document.

Legislation
The existing legislative framework

The existing compliance framework, rules and tests work where they are applied correctly and actively enforced.

The rules for assessing whether a workplace qualifies as a temporary place of work already exist although we believe that further clarification is required.

A combination of factors has resulted in this area becoming a pressure point and addressing the underlying cause of this pressure will deliver a far more robust outcome as opposed to current suggestions, which appear to miss the real issue.

The current proposals adopt a 'one size fits all' approach failing to identify, and recognise, the significant differences in the make up of the overall temporary workers market.

The outcome of this approach, particularly if this is underpinned by the concept of targeting over-arching employment contracts, will result in a range of new solutions that will not only circumvent the definitions it will also encourage a drive towards PSCs.

This action will result in a very diverse marketplace with effective compliance enforcement becoming increasingly difficult and costly.

Ultimately the current suggested course of action could result in an overall reduction in tax paid to the Exchequer and will certainly not deliver the predicted £400m.

We believe that creating an environment where the right classification of the worker is achieved at outset delivers a long term answer, allows the right workers to claim what they are entitled to and reduces the risk to tax revenues. It retains the flexibility of the temporary workers marketplace that is a an increasingly important element of UK PLCs workforce.

Assessing the status of the workplace.

Whilst there are many rules that cover the aspect of assessing the status of a workplace we would suggest that one in particular deserves special attention.

The rules for defining whether a place of work qualifies as a 'temporary workplace' are defined in s339 ITEPA 2003:

A "temporary workplace" (s339 ITEPA 2003)

- A temporary workplace is one at which the employee attends:
  in the performance of the duties of the employment,
  (a) for the purpose of performing a task of limited duration, or
  (b) for some other temporary purpose.

Based upon this rule, and where it is applied correctly, unless a worker is on a specific project based assignment for limited duration they fail this initial test. In failing this test the workplace cannot be classed as a temporary workplace, regardless of the workers future intentions.

This test also has to be applied by payment intermediaries using OACs and where the test fails they too are prevented from classifying the workplace as temporary resulting in no expenses being claimed.

This is another reason why we believe that the focus on OACs is incorrect and will miss the issue.

Agency workers in the past failed this initial test and therefore Agency Payroll was the answer.

As we have already highlighted in the History Section over the past few years there has been a significant reduction in the number of recruitment companies that offer their workers a PAYE solution.

Many non-compliant providers have entered the market with solutions specifically aimed at the lower paid worker, which has helped to accelerate this.

Additionally these payment intermediaries offer high financial incentives to recruitment companies who introduce workers.

These solutions fail to apply this test correctly and as a result workers that would have traditional been 'Agency Workers' working at a series of permanent workplaces and therefore unable to claim any travel and subsistence expenses are now offered alternatives that allow the claiming of expenses and this in turn can increase their take home pay.

We believe this is where the underlying issue exists and the aspect that needs to be addressed.

Ensuring the right categorisation of the worker, together with applying the correct tests, addresses the problem and protects the tax revenues.

If we examine the specific rule we find that examples given by HMRC in the various guidance documents illustrate the point of 'necessary attendance for a limited duration' but there is no guidance specifically on the aspect of 'limited or temporary purpose'.

In all of the examples and commentary provided HMRC themselves fail to consider the task and the purpose - the first test of qualifying the workplace's status.

As a result there should be little surprise that the rules are not being correctly applied or applied as intended.

Clarifying this single aspect and providing examples of acceptable and unacceptable situations is an important step in limiting the numbers of workers that are able to classify their workplace as temporary and in turn reducing the claims for travel and subsistence.

We believe that rather than attempting to find a set of words to describe the difference between an 'Agency Worker' and a 'Contractor' this test, when applied correctly, serves that purpose.

Where this clarification is supported by other factors, such as liability clauses, we feel that a realignment of the market will occur.

Furthermore it supports those genuine contractors who do travel to where the work is and in turn keeps the flexibility in the temporary workers market.

The power of the liability clause.

Following the introduction of the Offshore Employment Intermediaries Legislation and the Onshore Employment Intermediaries Legislation we saw significant shifts in the market driven by recruitment companies ensuring they were not operating in a way that exposed them to the liabilities contained within the legislation.

This shift demonstrates the power the recruiters have in influencing the structure and make up of the market.

Where the recruitment company feels there is too great a risk in dealing with a particular style of payment intermediary they will simply stop using that intermediary.

This results in the payment intermediary having no access to the market and faced with a simple decision: to either stop trading or come in line to carry on with their existing relationships.

By extending the liability clause contained within the Onshore Employment Intermediaries legislation to cover payment intermediaries who do not apply PAYE correctly we believe that the Pay Day by Pay Day providers would be removed from accessing their target market and be forced to change their offerings.

This extension of the liability should differentiate between systemic failings in the application of the rules and isolated incidents. This would then avoid a situation where recruiters would feel compelled to check all PAYE calculations carried out by providers to protect themselves from the liabilities.

If the liability clause contained an appeal for recruitment companies that were able to demonstrate that appropriate levels of due diligence had been carried out this would then further strengthen the compliance in the market.

Clear guidance on appropriate due diligence would need to be provided as we see many recruitment companies that rely on simple questionnaires where providers supply incorrect details and these are taken at face value.

Additionally where a recruiter receives any forms of payment, or incentives, from the providers the required level due diligence should be raised to achieve a success outcome to the appeal.

Enforcement of National Minimum Wage Rules.

We are seeing a growing number of providers that seek to manipulate the hours worked to reduce the levels of pay required under National Minimum Wage. This in turn increases the amount of money that is then available to offset expense claims.

We see wholesale abuse of this that leaves the compliant providers at a commercial disadvantage as they are unable to match the returns to the worker.

Once again the majority of these offerings are aimed at the lower paid worker who would have traditionally operated as an ‘agency worker’ on PAYE with no travel and subsistence expenses.

The most recent example we came across in the last few days was where a worker had worked for 60 hours in a week. The payment intermediary incorrectly claimed that the National Minimum Wage was only applied to their 'contractual hours' set at 37.5 hours for the week.

As a direct result there was a significant level of funds remaining, after the incorrect calculation of the National Minimum Wage payment, and these remaining funds were allocated against, what at first glance would appear to be, exaggerated expense claims.

The compliant umbrella providers would, in all cases, pay the National Minimum Wage against all the hours reported resulting in little, if any, funds remaining to offset genuine expense claims.

The first reaction when reviewing the low paid workers market is to assume that the levels of expenses must be low as the pay is low. However when seen in this context it is clear that the levels of expenses allowed by the non-compliant payment intermediaries is significant.

These processes allow low paid workers to claim high levels of expenses, often at a higher level than those available to higher paid workers operating through the compliant providers.

We regularly come across similar examples of this behaviour as well as situations where the worker does not even have to submit expense claims for expenses to be paid. HMRC are aware of the 'automated expense claims' and whilst they have confirmed they would challenge such instances we have seen no examples of this enforcement.

Workers often complain when they move to compliant umbrella companies as the process to claim expenses is more robust and therefore more difficult for the worker. The workers rarely understand the complexity of the arrangements and base their whole judgement on ease of use allowing the non-compliant providers additional commercial advantages in attracting workers.

Recruitment companies also regularly complain as a result of feedback from the workers. This can damage the relationship between the compliant provider and the recruitment company resulting in further commercial advantages for the non-compliant provider.

These examples are not isolated instances. They describe common practice across many of the non-compliant providers targeting the low paid workers. There are significant levels of tax loss resulting from these arrangements and without taking steps to prevent their increased market penetration these losses will continue to grow.

The existing framework for enforcement of National Minimum Wage exists and HMRC have reportedly increased their enforcement resources in this area. A focused campaign on this aspect of non-compliance should deliver a quick win as well as protecting significant levels of revenue. The current rules also provides a framework for public name and shame which we believe that when supported by an enforcement campaign, as well as public statements confirming the increased focus, will limit their use.

Our recommendation address this growing issue and we believe provide a robust response to ensure the low paid workers are categorised correctly with the correct application of the rules.

This will effectively remove these providers access to the market resulting in the increase in tax revenues and increased compliance across the sector.

CHOICES

THE RIGHT PEOPLE IN THE RIGHT SOLUTION

Choices
The right people in the right solutions

As a direct result of legislation changes contractors are restricted in their choices of operating structures when obtaining work through a recruitment company.

This is an important element to understand as many of the arguments made that structures are selected as a result of allowable expenses or for tax motivated reasons are simply wrong and misguided perceptions.

We disagree that a level playing field is achieved by a 'one size fits all' approach to the rules as this in itself will create an unlevel playing field.

This 'one size fits all' approach also fails to recognise the significant differences between the workers operating in the market and is likely to result in greater risk to tax revenues as more structures emerge to circumvent the rules.

We also believe that the suggested action fails to understand and address the route cause of the issue and therefore will fail in its application, if adopted.

What we describe below is, what we believe, to be the underlying issue that needs to be addressed.

Workers that obtain their work through a recruitment company have three contractual arrangement options available to them that are acceptable to the recruitment companies:

1. Work as an agency worker through the recruitment company payroll

Or

Work through an incorporated structure, this provides two alternatives:

2. Operate through a payment intermediary

Or

3. Work through their own limited company

Agency Payroll

Historically the worker operating through the agency payroll was either on a lower rate or less skilled and in almost all occasions failed the first test of assessing the workplace as temporary, as defined in s339 ITEPA 2003.

The 'agency worker' has been unable to claim travel and subsistence expenses as they were deemed to be working at a series of permanent workplaces.

As we have already highlighted many recruitment companies have moved away from offering an agency payroll option resulting in far fewer workers in the 'Agency Worker' category.

This move away from agency payroll has resulted in a lack of transparency in the market as many workers are now only offered one rate when taking an assignment: the limited company rate.

This effectively restricts their operating options to an incorporated structure: either a payment intermediary or their own limited company.

The MSC legislation has provided an effective deterrent from providers moving the lower paid workers in to their own limited companies resulting in effectively only one choice for many workers: a payment intermediary.

The combination of an increase in non-compliant providers with offerings specifically designed for low paid workers and a significant financial incentive for recruitment companies has accelerated this change.

Many of these workers fail to grasp the arrangements they are entering in to and are motivated entirely by the assignment being offered and the returns promised by the payment intermediary.

This naivety assists the non-compliant offerings to grow and flourish, as often their presentations are credible to the uninformed.

Without a direct comparison to PAYE these workers are unable to see, appreciate or understand that in many cases they could be worse off as a result of the additional charges they are incurring from the provider.

In an attempt to redress this balance the non-compliant offerings ignore the temporary workplace tests as defined in s339 ITEPA 2003 and automatically assess each workplace as temporary allowing the workers to reduce their tax liabilities through the claiming of expenses and masking the true cost of the arrangements being offered.

We believe that this move away from agency workers fuelled by the incorrect application of the temporary workplace tests contained within the existing rules is where the greatest threat to tax revenues exists.

Taking steps, and we suggest some in our recommendations, to address this issue and ensure the correct categorisation of workers not only protects tax revenues but also helps create both a more level playing field and provides protection from exploitation for vulnerable workers.

Payment Intermediaries

We specifically use the term payment intermediaries, as many companies that call themselves umbrellas would not meet our definition of an umbrella company.

Currently no definition of an umbrella company exists and therefore many providers use the term in an attempt to mislead either the workers or the recruitment companies they seek to develop relationships with.

We feel that defining an umbrella, in the same way that the MSC legislation defines MSCs and MSCPs would be a positive step forward in helping deliver a better understanding to the market of a compliant umbrella provider.

We understand the focus on over-arching employment contracts although we believe this in itself is not the issue.

Responsibly run and compliant umbrella providers are unable to take on workers that operate at lower rates. Furthermore they actively test and apply the rules for temporary workplace and we see many examples of workers unable to claim expenses as a result of failing these definitions.

As the recruitment companies no longer offer a PAYE alternative the worker has no choice but to still work through the umbrella if they want to take the offered assignment.

Many of the responsible umbrella providers carry out a direct comparison with the returns from PAYE and where the returns through the umbrella are lower they refer workers back to the recruitment company suggesting they take the PAYE alternative. This referral back to the recruitment company often creates tensions between the recruitment company and the umbrella as the recruitment company is either reluctant to offer a PAYE rate or has no payroll service in place.

This has put many compliant and responsibly run umbrella companies at a commercial disadvantage in the market.

In recent times we have seen an increase in alternative solutions, all claiming to be compliant. A number of these have already moved away from the use of over-arching employment contracts and therefore would fall outside the scope of the suggested changes.

If the focus on over-arching employment contracts remains there is a danger of making a similar error to that made in the introduction of the Onshore Payment Intermediaries Legislation and providing a further advantage to these alternative solutions which ultimately will result in a reduction of tax revenues.

Three years prior to the introduction of the Onshore Payment Intermediaries legislation HMRC had declared that the Pay Day by Pay Day provider was operating outside the scope of the PAYE regulations and yet the liability clause within the legislation failed to catch these providers. The result being that they continue to offer their solutions with recruitment companies safe in the knowledge that it falls outside the scope of the new Onshore Employment Intermediaries liability clauses.

What we did see happen as a result of these new liability clauses, in cases where they could be applied such as self-employed workers and offshore providers, was a dramatic change in recruitment company behaviours away from where a potential liability existed.

We believe that an amendment to the liability clause extending it to cover any payment intermediary who did not apply PAYE correctly would replicate that behaviour and result in a move away from solutions such as Pay day by Pay Day where HMRC had already clarified their view of such arrangements.

PSCs

The MSC legislation, or more accurately the Debt Transfer Rules, has provided a good deterrent in the market and providers offering accountancy service solutions to contractors have, in the main, detailed processes and procedures in place to ensure they do not fall foul of the rules.

The most basic of these processes is a suitability test on workers looking to operate through their own limited companies.

The suitability tests ensure that only those workers with a long-term expectation to contract and who operate at higher rates are considered for operating through their own limited companies.

Furthermore the providers then go on to ensure that the worker fully understands the responsibilities that comes with having their own limited company.

Many contractors who are setting out on a career of contracting may opt to use the umbrella provider initially as this provides a simple route for them to ensure that contracting is for them in the longer term.

Where they then decide that contracting is for them these workers will ultimately will move from umbrella to running their own limited company.

We believe that the proposed changes would unbalance this dynamic and a significant proportion of first time contractors would move straight to PSC.

Many contractors currently within umbrella structures would also look to move as the difference in returns between structures would become significant therefore driving this change in behaviour.

Under the new rules the contractor would be facing a decision of between 65% take home and up to 83% through their own limited company.

Whilst the MSC legislation and Debt Transfer Rules would prevent a wholesale move of workers there are a significant proportion of umbrella workers, through the compliant and responsibly run providers, that can easily justify operating through their own company.

Enforcement of MSC Legislation, as with much of the legislation and HMRC enforcement processes, makes it complex and comes with a lengthy process of enforcement.

Non-compliant providers could see this as an opportunity and setup ever changing structures that HMRC would find difficult to trace and monitor.

As The Financial Services Sector confirmed effective compliance enforcement is difficult, expensive and ineffective across a diversified marketplace. The proposed changes would drive this diversification in the market and the rules alone would not deliver compliance.

Compliance
The risk reward balance

For many years Professional Passport has campaigned to create a level playing field in the market and remove the many commercial disadvantages faced by the responsibly run and compliant umbrella companies.

Whilst some of the changes have assisted in moving this objective forward the consistent and ongoing challenge has always been the number of providers within the market that are prepared to operate outside of the rules with alternative structures.

Professional Passport has seen a growth in the number of companies seeking compliance reviews and becoming 'Approved Providers' of Professional Passport as we have developed strong relationships with many recruitment companies.

Many higher end recruitment companies now insist that a provider must have passed our compliance assessment to be considered for any PSL agreements.

Building these relationships has resulted in commercial advantages for the providers who achieve our standards.

Whilst this has been a positive move forward for compliance the majority of the recruitment companies that rely on Professional Passport accredited providers operate at the higher end of the market and therefore once again fall outside of the areas where we believe the real issues exist.

Recruiters operating with low paid workers are unable to rely on our accreditation process as we cannot accredit providers that operate structures designed for low paid workers.

Providers operating across the market, evidenced by the many discussions we have, tend to fall in to four broad categories:

- Compliant and want to ensure ongoing compliance
- Have a culture of compliance although have short comings due to lack of detailed knowledge
- Set out to be compliant but commercial pressures quickly change their models
- Are focused entirely on the commercials and have a low regard, or in extreme cases a complete disregard, of the rules and compliance and are entirely motivated by the financial returns for the directors

Compliant and want to ensure ongoing compliance

These companies are seeking to build real businesses for the long term as they recognise the size and potential contained within the market.

They represent our target market for our compliance accreditation.

They all share the Government's objective of a level playing field as for many years they have suffered commercial disadvantages as a result of the non-compliant structures.

As a direct consequence of their focus on compliance they tend to operate with higher costs as they are required to operate more in-depth processes and procedures to ensure the correct application of the rules.

These higher costs creates a further commercial disadvantage to them as often they are unable, or unwilling, to compete with the financial incentives offered to recruitment companies by the non-compliant structures who lack this depth of process.

This has resulted in them moving in to markets, and working with recruiters, who supply workers at the higher end and share the same high principles of compliance.

We have seen, as a result of the legislation introduced in 2014, an increase in the numbers of companies that have moved to a higher compliance standard although, once again, this tends to be at the higher end of the market.

Many of our approved providers have been subject to HMRC reviews and found to be applying the rules as intended in a robust manner.

Have a culture of compliance although have short comings due to lack of detailed knowledge

In our work with providers we found a high level of appreciation of the concept of an umbrella provider although, in many cases, the depth of operational processes and procedures to create a rounded and robust compliant solution was less well understood.

Many advisers in the sector failed to address or highlight the complexity of the processes and focussed solely on the contractual terms. This created a perception of low barriers of entry in to the market as OACs are widely available to purchase off the shelf. We have recently seen one offered at £50 which on close inspection failed to grasp the complexities of the arrangements.

When working with this group of providers we found them open to the detail and they quickly updated and amended processes and procedures to bring them in to line with the expected processes for compliant providers.

This population has been growing as the new rules take effect although once again they tend to target relationships with recruiters operating at the higher end of the market.

Set out to be compliant but commercial pressures quickly change their models

In this area we see providers who set out with all the right stated intentions but find their access to the market difficult.

The access to workers is generally controlled by recruitment companies either through their preferred supplier listings which can be founded on either principles of compliance or financial incentives. Many operate with a focus on financial incentives allowing the non-complaint provider immediate market access as they offer the highest incentives.

Compliance

The risk reward balance

At the higher end of the market many established providers with a long track record of robust compliance have a strong relationships in place, founded on the principles of compliance, making it difficult for new entrants to establish new relationships with these recruitment companies.

Recruitment company preferred supplier lists are reviewed infrequently leaving many new entrants finding it difficult to build relationships and gain access to their preferred marketplace.

This leaves the new umbrella provider competing on commercial incentives for business. They quickly recognise that their competitors in this area often operate with light processes and procedures that fail to meet many of the required level of compliance checks. This allows the competitors to win in almost all situations that are assessed on the Financial incentives offered.

This difficulty in accessing the market drives many new entrants to mirror the competitors models, and structures, in an attempt to stay in business. This market dynamic has accelerated the growth of non-complaint structures in the market.

They see little visible enforcement being applied and so a perception of 'implied compliance' is created.

Recruitment companies operating at the lower end of the market have recognised that they do not have risks of liabilities as a result of the Onshore Employment Intermediaries Legislation introduced in 2014 and are therefore using the growth in non-complaint providers, and the increased competition between them, as a way to drive their incentives up. This results in a large profitable income stream to the recruitment company at a time where there is high competition and a pressure on the recruitment company rates and margins.

As competition for business in the non-compliant market has increased there have been a growing number of providers prepared to stoop to new levels with models that show a complete disregard of the rules.

Many of these models are built with a recognition that they have a very limited shelf life. As a result they have low operating costs, resulting in non compliance, whilst maintaining an ability to provide some of the highest financial incentives to the recruitment companies prepared to use them.

Presentations to recruitment companies often centre in on the savings that can be made by moving their low paid workers in to the arrangements based around how a recruiter can get rid of the costs of running their own payroll. Effectively showing the recruitment a current cost in to significant profit with little risk.

As these providers disregard the rules they are often able to provide the workers with a higher take home pay than they were previously experiencing on the agency payroll, even after their charges, and so the workers are happy to make the move.

Once they have created a 'foot in the door' with the low paid worker option they then try and acquire a greater share of the recruiters workers often at the expense of the compliant structures.

When we then compare the charges of providers operating across these four categories generally they are very similar. The complaint provider needs these charges to cover the costs of the processes to deliver compliance and the non-compliant provider needs similar levels to provide the financial incentives that are critical to them accessing the market.

It is our belief that there are not enough disincentives or liabilities to companies, and their directors personally, to stop this behaviour. If the proposed changes were put in place then the non-compliant sector will grow dramatically resulting in an overall loss of tax revenues.

The Recruitment Company Marketplace

The market place of recruitment companies can be segmented in a similar way to that of providers.

At the higher end of the market we see recruitment companies that hold compliance as a non-negotiable when selecting the providers they build relationships with. In many cases robust compliance comes above financial incentives, although we are seeing the attraction of the financial incentives beginning to enter all sectors.

The recruitment company, at this end of the market, either aligns themselves to a third party specialist compliance assessor, such as Professional Passport, or builds their own provider compliance assessment processes. Many of these processes have now developed past the single sheet questionnaire that has been shown as completely ineffective.

They have recognised the duty of care they hold towards their workers when recommending a third party service provider and taken their responsibilities seriously.

At the other end of the scale their is the recruitment company who has little or no appreciation of the rules that apply within the sector and are solely focussed on placements and financial returns. Financial returns are now a combination of their margin and the financial incentives offered by the non-compliant providers.

They tend to operate with lower paid workers and deal in high volumes.

Their assessment of provider relationships is built wholly on the financial incentives that are in place from the provider with no real understanding, or appreciation, of the model being used.

Their minds are put at ease by Barristers Opinions and a lack of evidence of visible enforcement by HMRC.

The failure of the liability clauses, within the Onshore Employment Intermediaries Legislation introduced in 2014, to catch many of these non-compliant structures has resulted in a greater access to market for the non-compliant providers as a result of a growing number of recruitment companies prepared to use them.

All of these factors combined have created, what we would call ‘a race to the bottom’.

Failure to address this will result in the continued use, and growth, of this sector with the resulting risks to tax losses.

End Users

The work we do with end clients suggests that there is a low understanding of the structures used by their temporary workers supplied through recruitment companies.

This low awareness has allowed the recruiters to remain in complete control of the providers they decide to form relationships with and offset the pressure on margins by the financial incentives so widely offered.

Many of the decisions made by the end users are based upon recruiters who are able to deliver the right quality and quantity of worker for their needs at the most commercial rate.

We have recently seen an increase recently in awareness in supply chain compliance amongst end users as a result of HMRC awareness activity and we would suggest that these efforts need to be increased.

End users hold no liabilities in the recently implemented legislation and seem to rely on their recruitment partners to ensure supply chain compliance on their behalf.

There also seems to be a lack of appetite to include end users in any of the liability clauses within the legislation.

For this reason we would suggest that any action needs to be supported by a campaign of awareness to end users highlighting risks across a number of areas:

- Obligations to check supply chain compliance citing existing regulations that require them to carry out these checks.
- Brand and reputation damage where there are cases of supplier non-compliance and the risks of negative press coverage that could be a consequence of engaging temporary workers who are paid below the National Minimum Wage.
- The new transparency achieved through the reporting requirements that commence in April 2015 and the associated risks where supply chain compliance is not achieved.

We believe that where end clients are fully informed of the risks together with the transparency that the new reporting requirements will bring then this will drive a change in behaviour from the top of the supply chain.

We would also suggest that where end users have failed to make any checks on supply chain compliance, and failings are found, then they too could be named under our proposed name and shame rules.

This risk will underpin the drive in achieving supply chain compliance and the brand and reputational risks associated with any name and shame policy would significantly increases the focus by end users in this area.

By including all parties it creates a market alignment and delivers a behaviour change top down delivering a more robust outcome in protecting tax revenues.

REACTIONS

FOR EVERY ACTION THERE IS AN EQUAL AND OPPOSITE REACTION

Reactions

For every action there is an equal and opposite reaction

We do not believe that the forecast of returns in the Discussion Document of £400m in additional revenues as a result of the action will be fulfilled and we would actually forecast a potential reduction in the overall tax take.

As we have highlighted throughout our document the responsibly run and compliant umbrella providers are applying the existing rules as intended, resulting in many workers being unable to claim expenses when using an umbrella company.

The pressure point is, in our opinion, the rise in alternative models and structures that seek to circumvent the rules or, in many extreme examples we have seen, completely disregard the rules.

This rise in non-compliant providers demonstrates that amending the rules will not deliver the results forecast and merely penalises both companies and workers who have been applying the rules correctly.

It fails to address the core issue of worker categorisation and therefore will have the greatest impact on the compliant providers and allow non-complaint structures to maintain a commercial advantage in the marketplace.

It fails to recognise the alternatives that will emerge and the impact these will have on the forecasted increase in revenues.

If these proposed actions are followed through we would anticipate the following reactions in the market:

- **Growth in EDM model**

  We would expect many providers to move to an EDM model.

  The EDM model does not utilise OACs and therefore would fall outside the scope of the current proposals.

  Many of these models are also used to avoid other legislation aimed at protecting workers such as Agency Workers Regulations, Pensions Auto Enrolment and National Minimum Wage and the employment rights delivered by the compliant umbrella providers.

  Furthermore it fails to create the 'level playing field'; in fact it is likely to make the 'playing field' more exaggerated.

  The overall result being a reduction in tax revenues as well as workers being less protected.

  We do not see that this meets any of the stated objectives outlined in the discussion document.

- **Emergence of new structures**

  The market has, on many occasions, demonstrated the ability to deliver new variations of models that are designed to circumvent the rules.

REACTIONS

FOR EVERY ACTION THERE IS AN EQUAL AND OPPOSITE REACTION

We are already aware of a number of new structures under review that would also achieve this.

These new structures would result in an overall reduction in the tax revenues collected by the Exchequer whilst maintaining a broad appeal to workers across the market.

- **Move to PSCs**

Many workers currently operating through the compliant umbrella companies do so through choice.

Compliant umbrella providers have a significant number of workers on rates that would allow many of their employees to pass a suitability test for operating through a PSC. They select the umbrella as they do not want the additional responsibility, and workload, that comes with having their own PSC.

The changes proposed would significantly alter this dynamic resulting in many more workers moving to a PSC structure.

Additionally with IR35 enforcement proving difficult and lacking any real penetration with current enquiry levels only assessing around 0.2% of the PSC marketplace. If there was a greater shift to PSCs we believe that many of these workers would select to assess their contracts as outside IR35 resulting in a further reduction of revenues to the Exchequer.

Many workers setting out on their contracting career favour the umbrella provider as their first operating structure. The umbrella provides them with a simple and convenient risk free approach to assess whether contracting in the longer term is for them.

The current proposals change the balance of this and we believe that many would select to operate through their own limited company from outset.

- **Increase in self-employed**

With the new rules being aimed specifically at the umbrella provider, or those that use OACs to be more accurate, we would predict an increase in workers operating as self-employed.

This effectively reverses the move as a result of the Onshore Employment Intermediaries Legislation of 2014.

The proposed changes will impact the take home pay of many workers and, as a result, we would expect the pressure on both recruitment companies, and end clients, to clarify the Direction, Supervision and Control within assignments to increase, resulting in a return to self-employed for many.

Reactions

For every action there is an equal and opposite reaction

- **Pressure on Rates**

As workers pay will be directed impacted by the proposals we would anticipate a resulting pressure on rates from the sector.

This pressure on rates and will result in either an increase cost to end users or a reduction in margins for recruitment companies. This being the case it will accelerate new engagement models emerging in the market.

We are already seeing some umbrella providers seeking to develop relationships directly with end users for the supply of their workers. This move removes the recruitment company from the supply chain and results in many pieces of legislation becoming redundant.

All the latest legislation has been designed around a recruitment being in the supply chain, if there was no recruitment company in the supply chain then the legislation does not apply.

Where pressure on rates was too great this could easily accelerate a change in engagement models. The workers would then have a much broader range of options to operate under without any party holding risks or liabilities.

This highly possible market reaction in itself fails to meet the objectives of the level playing field set out in the discussion documents and puts tax revenues at risk.

Quick wins

Protecting tax revenues and achieving compliance

We believe that creating a successful framework for compliance involves a combination of factors and is not solely rules based.

Rules create the framework and these must then be supported by clearly defined consequences to encourage the adherence to the rules.

The combination of these two elements limits the numbers that will then be prepared to break the rules and allows for a more targeted and effective enforcement regime to exist; the third aspect of creating a compliant marketplace.

There is a clear and distinct difference between an isolated instance of a breach to the rules and a systemic failing in the correct application of the rules.

Enforcement should be supported by clear consequences where systemic failings are found; the Financial Services Sector has successfully made this distinction in its rules with systemic failings resulting in public name and shame as well as heavy penalties.

This has been shown to work very effectively where it is developed within a structure of a controlled marketplace, as opposed to a diverse population. When also supported by the correct liability clauses, even extending these to Directors personal liabilities, it reduces the instances of non-compliance.

The following points highlight our suggested actions that should be aimed for delivery in the Budget of 2015.

The section following this looks at longer term suggestions that could be considered after reviewing the impact the initial changes have had on the make up and structure of the market following submission of the first reports due from recruitment companies in August 2015.

We have broken our suggestions in to, what we believe to be, the three component parts to deliver a compliant market and the move towards a level playing field, something every compliant provider has been asking for:

- The rules to create the framework for compliance
- The risk reward balance
- Effective enforcement

Quick Wins

Protecting tax revenues and compliance

The rules to create the framework for compliance

- **Clarify, and if required amend, s339 ITEPA 2003 to be clearer on the tests that need to be applied.**

  Provide clearer guidance, with examples specifically aimed at the temporary workers market, of situations that both meet and fail the tests.

  Making this simple change will limit the numbers of workers able to assess their workplace as a temporary place of work reducing the levels of expenses being claimed for non qualifying workplaces.

- **Create a rule to prevent workers claiming Travel and Subsistence where they do not have a 'significant journey'**.

  One characteristic of the 'contractor' as opposed to the 'agency worker' is that a contractor will often travel across the country to where the work, aligned to their skill set, exists. Traditionally employees, and 'agency workers' tend to operate in close proximity to their homes as they are required to make that journey everyday for extended periods.

  Implementing a rule that would prevent the claiming of any travel and subsistence expenses on journeys below a specified distance would further limit those workers who would qualify.

  In research we have carried out we would suggest that those that live within a 10 mile radius of their place of work are removed from the ability to claim such expenses.

  Compliant umbrella providers already run tests on workplaces and this rule would not have a significant impact on their current operational processes and procedures.

  When combined with our suggestions including the PAYE Test it limits those workers who are able to operate through a payment intermediary and further supports getting the worker in to the correct structure.

- **Require a PAYE test by payment intermediaries**

  All payment intermediaries should be required to ensure that a worker does not receive less pay as a result of using the payment intermediary than they would have done if they were paid PAYE.

  We accept that this rule alone could encourage a move to increased expense claims being encouraged however, when supported by the clarification to s339 we have suggested together with the provider liabilities for systemic failings this will limit this behaviour.

This rule also ensures that workers who are 'forced' to use a payment intermediary are not disadvantaged as the payment intermediary will be unable to charge a margin if the PAYE test fails. Commercially there is then little incentive for payment intermediaries to work with the lower paid as they will effectively be providing the service free.

The application of this rule also provides a safety measure for the exploitation of workers as it will restrict the margin deduction a payment intermediary can make. We are seeing a number of payment intermediaries that have significant deductions,many of these are hidden or disguised from the worker.

This test will also impact the incentives being demanded by many recruitment companies as payment intermediaries are less likely to pay for business that they are unable to make money on.

Many of the compliant umbrella providers already run these tests however as a result of the move away from agency payroll and the significant reduction in the numbers of recruitment companies that now offer a payroll solution they can find this damaging to their recruitment company relationships.

- **Define an umbrella company and the characteristic that would be found in a compliant umbrella.**

  This provides the recruitment company with a clearer understanding and would reduce the number of providers using the term umbrella in an attempt to mislead.

  As we suggest below a wider range to the liabilities contained within the Onshore Employment Intermediaries Legislation this definition would help to support the recruitment company in their assessment of the providers compliance.

  Support this with examples of acceptable and unacceptable practices. This guidance should focus on the common failings and needs to go beyond just tax law.

  We do accept that this rule change may be more difficult to implement by the Budget of 2015 and may fall in to the category of long term review however it is an important part of the overall application and enforcement of compliance.

Quick Wins

Protecting tax revenues and compliance

The risk reward balance

- **Amend the existing liability clauses contained within the Onshore Employment Intermediaries Legislation to cover instances where PAYE is not applied correctly.**

  This needs to relate to systemic failings as opposed to any instance which allows the non-compliant providers to be caught whilst removing a need for recruiters to test every payroll calculation run by a provider.

  Support this with an appeal process where the recruiter, or a specialist company on behalf of the recruiter, has carried out significant due diligence of the providers application of the required processes.

  Provide clear guidance on acceptable due diligence as we see many simple questionnaires where providers simply answer questions incorrectly to build a relationship and obtain the business.

  Increase the level of due diligence required where a recruitment company receives any financial or other incentive from the provider as a result of the relationship.

- **Providers Debt Transfer Rule for systemic failings**

  Create a rule, similar to that found within the MSC Legislation, for any payment intermediary that has systemic failings in the application of the rules. In this case we would suggest that the Debt Transfer applies to the Provider Company and the Directors personally of that company and precludes the recruitment company and worker.

  Recruitment companies would be caught by our previous suggestion in the extension of the Onshore Employment Intermediaries Legislation liability clause where they had insufficient evidence of due diligence.

- **Create name and shame rules for systemic breaches**

  Create the ability to name and shame any provider and its directors where systemic failings in the application of the rules are found. This rule could be based on a similar rule found in relation to the incorrect application of National Minimum Wage.

  Where systemic failings are found and the provider settles there should still be the ability to name and shame.

  Consider including the recruitment company and end user in any name and shame rules where they cannot provide sufficient evidence of due diligence checks being carried out on the provider.

- **End user awareness**

  Support any action with an awareness campaign to end users highlighting the associated risks where the supply chain for temporary workers is non-compliant.

  If end users are included in the name and shame rules provide clear guidance on due diligence requirements to successfully mount an appeal.

Effective enforcement

A key aspect of any effective compliance enforcement is visibility of enforcement activity.

The Financial Services Sector have found this to be the cornerstone of effective enforcement.

Effective enforcement relies on a number of factors:

- Adequate resources and expertise to apply the enforcement of the rules.
- The ability of the enforcer to act quickly when rules are breached.
- Significant consequences in the form of liabilities and penalties for breaches that can be passed to the directors personally.
- Recognising trends that apply across the sector and having focused campaigns on enforcement targetting identified trends in wrong behaviours.
- Name and shame companies and directors for systemic breaches.
- Clear public information and guidance.

The Financial Services Sector provides many examples where enforcement campaigns have been mounted and these have proved to be very successful. The latest was the mis-selling of Payment Protection Plans which resulted in significant fines and penalties for organisations that fell short of the requirements.

We believe that HMRC should announce and mount campaigns on specific known compliance shortfalls where existing rules are already in place.

- **We would suggest the first enforcement campaign focus on National Minimum Wage Enforcement.**

  There are a number of reasons for suggesting this area:

  - We know that non-compliant providers use the incorrect application of National Minimum Wage Regulations as a way of increasing funds available to allocate to expenses resulting in tax loss to the Exchequer.

Quick Wins

Protecting tax revenues and compliance

- We know that many non-compliant models use this as a way to target the lower paid worker allowing them to operate through a payment intermediary and circumventing the 'agency worker' rules.
- The existing rules framework already allows for fines and penalties as well as public name and shame.
- Consider extending the rules to allow name and shame of all parties in the supply chain where the breach is found in relation to the supply and use of temporary workers.
- Additional resources have been allocated to ensure correct application and enforcement of these rules.
- The investigations in to the correct application of National Minimum Wage are likely to also lead to other issues being identified.
- The campaign closes one of the aspects used by many non-compliant companies and therefore protects tax revenues.
- Breaches are easily identifiable and where they are found action can be taken quickly.

Long Term Review

Maintaining and building a successful flexible workers market that will stand the tests of time

Whilst Government documents always comment on the importance of maintaining a flexible workers market and the fact that it plays such an important and vital role in the delivery of the results in the economy we do not believe that a full understanding and appreciation of the make up of the market exists.

References to historic comments made about the sector clearly demonstrates a lack of understanding of how this marketplace has matured over the last ten years and how for many this is now their 'career' of choice.

Many wrong and misguided perceptions are built as a result of this lack of detailed understanding and these present a risk to the market as they can result in inappropriate actions being taken.

All major business groups predict this market will continue to grow and that it provides the flexibility required for many businesses to succeed in the fast moving modern business world.

UK PLC leads the world in this area and we believe that significant commercial and economic benefits come to the country as a direct result.

For this reason we would advocate creating a working group of representatives from all the sectors within the market to carry out a full review and produce recommendations to Government on actions that will help the market to continue to develop as expected whilst at the same time being subject to rules appropriate to the market to prevent both the risk to tax revenues and the exploitation of vulnerable workers.

The review should go beyond tax legislation and look at all legislation and regulations affecting the market encompassing various Government Departments which should include:

HMRC
BIS
UK Border Agency

We believe that achieving a greater knowledge and understanding of the dynamics of this marketplace will allow appropriate checks and balances to be put in place whilst at the same time maintaining the vital role it provides in supporting the results in the economy.