



HM TREASURY



HM Revenue
& Customs

False self-employment in construction: taxation of workers

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Subject of this consultation:	This consultation outlines the Government's proposal for addressing the problem of false self-employment in construction. For a detailed explanation of false self-employment please see paragraphs 2.1 to 2.4.
Scope of this consultation:	The Government wishes to ensure that construction workers engaged in an employment relationship are taxed appropriately. The objective of this consultation is to develop the best legislative approach.
Impact Assessment:	An Impact Assessment is available at Annex A.
Who should read this:	This consultation is primarily for workers and engagers in the construction industry, their representatives and advisers. However, the Government welcomes views from all interested parties.
Duration:	The consultation starts on 20 July 2009 and comments should be sent by 12 October 2009.
Responses & enquiries:	<p>If you wish to respond to this consultation document, raise an enquiry about the scope of the consultation document or request a hard copy please contact:</p> <p>Lisa Fitzpatrick False self-employment in the construction industry consultation Personal Tax Team HM Treasury, 2/SE 1 Horse Guards Road London SW1A 2HQ</p> <p>Or e-mail: construction.consultation@hm-treasury.gov.uk</p> <p>Telephone queries: 0207 270 5330</p>
Additional ways to become involved:	The Government may hold meetings with interested parties. Please contact Lisa Fitzpatrick at the above address if you would be interested in attending a meeting.
After the consultation:	The Government will collate and publish key responses as soon as possible after 12 October 2009.
Getting to this stage:	At present the person engaging a worker has an obligation to determine whether he is self-employed or employed for income tax and National Insurance (NICs) purposes by applying a series of case law tests. Evidence suggests that there are a substantial number of workers in the construction industry working under employment terms who are presented as self-employed. Previous attempts to address this problem, for example, through compliance activity, have been unsuccessful. The Government has concluded that the best way to address this issue for income tax and NICs purposes is to introduce legislation.
Previous engagement:	The Government has consulted a number of key stakeholders, including industry representatives and trade unions, to identify the problems with false self-employment and possible solutions.

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1

Introduction

1.1 At Budget 2009, the Government announced that it remained committed to addressing false self-employment in the construction industry and would consult with a view to future legislation to ensure that construction workers engaged in an employment relationship were taxed appropriately. The Government also confirmed that it would work with the construction industry to ensure that any legislation was targeted and that the industry retains a flexible labour supply.

1.2 False self-employment occurs where workers are treated as self-employed for income tax and National Insurance (NICs) despite the fact that the way in which the work is carried out on a day to day basis demonstrates that there is an employment relationship. There is evidence to show that a significant number of workers in the construction industry are engaged on the basis that they are self-employed, but are working under employment terms.

1.3 The problem of false self-employment affects not only the ability of compliant businesses to be competitive, but also workers' entitlement to benefits, as well as representing a risk to the Exchequer.

1.4 The Government has concluded that the best way to address this issue for income tax and NICs purposes is to introduce legislation which deems workers within the construction industry to be in receipt of employment income¹ unless one of three simple, clear and easy to apply criteria, set out at paragraph 5.11, is met. If the worker is deemed to be in receipt of employment income, Pay as You Earn (PAYE) and NICs will be due on the payment he receives.

1.5 However, it is intended that the introduction of the test should not have an adverse impact on those genuinely carrying on a business and the test has been formulated to achieve this. The Government recognises that a flexible labour supply is important to the industry and that the self-employed workers who are carrying on a business make an important contribution to this.

1.6 This measure will only deem a worker to be in receipt of employment income for the purposes of income tax and NICs and will not confer employment law rights on a worker. However, the Government hopes that the tax changes would also engender a more appropriate treatment of workers throughout the industry, leading to a culture of responsible employers applying employment rights and providing training opportunities.

1.7 The objective of the consultation is to develop the best legislative approach, ensuring that it is fair, clear and can easily be applied, and to understand the potential impact of any legislation. In deciding how and when any legislation will take effect, the Government will take account of the comments that are made in response to this consultation process as well as the wider challenges facing the industry. In particular, the Government recognises the effect that the economic downturn has had on the construction industry and intends that the measures developed as a result of this consultation will take effect when the industry is in a stronger position.

1.8 Chapter 7 sets out details of the consultation process. Comments should be submitted by 12 October 2009.

¹ For the purposes of this document, the term "employment income" is taken to include earnings for National Insurance purposes

2

What is the issue of false self-employment?

What is meant by false self-employment?

2.1 Where workers, in whichever business sector or industry, provide their services they do so for income tax and National Insurance (NICs) purposes either on a self-employed basis or an employed basis. In order to determine how a worker should be treated, a series of tests has been developed through case law. These include such considerations as who controls the work, who takes the financial risk and whether the worker is in business on his own account. These are applied to the facts and circumstances and the terms of the engagement in order to decide whether the worker should be treated as employed or self-employed. The Pay as You Earn (PAYE) and NICs legislation imposes an obligation on the person engaging the worker (the “engager”) to determine the status of a worker by applying these tests. This obligation applies across all industries and sectors and includes engagements within the construction industry.

2.2 Engagers also have to ensure that from an employment law perspective the contract with the worker properly reflects the reality of the relationship.

2.3 False self-employment occurs where the underlying characteristics of the relationship are employment but the engagement is presented as self-employment. This is primarily driven by the differences in tax and NICs treatment of the self-employed and employed, which are as follows:

- employer’s NICs are due on payments to employees, but not on payments to those engaged on a self-employed basis;
- the self-employed pay NICs at a lower rate than the employed; and
- the self-employed are taxed on the profits of their business and the rules on what they can deduct from the gross income are more generous than those applied to employment income.

2.4 As a result of these differences, workers and engagers have a financial incentive to attempt to portray their employment income as income from self-employment in order to reduce their tax and NICs liabilities. However, there are also non-tax pressures which can influence the decision, such as the costs for employers of holiday pay and pension contributions.

What is different about construction?

2.5 Within all industries and sectors it is the case that certain services will be provided on a self-employed basis and this is no different in the construction industry. However, within this industry there is a much higher proportion of self-employed workers than in other sectors. The results from the European Labour Force Survey 2007 showed that 34 per cent of workers in the construction industry are self-employed, compared to only 11 per cent across other sectors. Even given the range and variety of skills used by the industry, there is no obvious reason why the proportion of self-employed workers in the construction industry should be so high.

2.6 In addition, both HM Revenue and Customs’ (HMRC) compliance activity and statistical evidence points towards there being a substantial number of workers in the industry, working under employment terms but being presented as self-employed. Given the nature of

construction work, the supply of materials, plant or equipment is key to the completion of any contract. In 2007/08, the Government estimates that there were 300,000 subcontractors operating within the Construction Industry Scheme (CIS)¹ who did not claim any deduction for the costs of materials, nor for plant and equipment. These subcontractors provided none of the materials or plant and equipment which would form a substantial element of any contract and provided only their labour. The Government believes that a large proportion of these subcontractors, who represent approximately one third of the active subcontractor population, and are operating as sole traders, will in fact be working under employment terms.

2.7 Furthermore, HMRC compliance activity has shown that in practice these engagements will also display other features which are closer to employment. These include a large measure of supervision and control by the engager, a lack of financial risk, an obligation for personal service, and lengthy periods with the same engager.

2.8 Whether a worker should be treated as an employee or self-employed for income tax and NICs will depend on the facts and how these are presented. A slight change in presentation of the facts can have a significant impact on the decision reached, which is illustrated by the comments in the decision of the Special Commissioner, Mr H M Nowlan, in the recent case of *P J Wright v HMRC*.²

Box 2.A: Comments by Mr H M Nowlan, Special Commissioner in the case of *PJ Wright v The Commissioners for HMRC*

"The case involved similar facts in many respects to those in the Appeal brought by C Limited that I decided in October 2008, largely allowing the Appeal, and thus reaching the conclusion in that case that the vast majority of the workers were not employees. The respects in which the facts were similar were that the workers in both cases were engaged by a trader that contracted on a sub-contract basis to undertake particular aspects of building work for main contractors (mainly bricklaying work in the C case and groundwork in the present case); the workers were engaged on a flexible basis under which they could be terminated, and could cease work, broadly without notice; they were paid only for hours or periods of days actually worked; they received no pay in the event of illness, or when on holiday or when absent for any other reason, and all the workers provided CIS cards such that they were paid net of the 18% or 20% required to be deducted under the Constructors' Industry scheme in respect of the workers' potential liability to income tax."

Later in his decision he commented, "There are certainly many factors in this case that were similar to the facts in the C case in which I concluded that the bricklayers and the majority of the other workers were not employees. I will set out ...below why I consider that my contrary decision in this case is not in conflict with the C decision, albeit that I do accept that there are some similarities between the two cases."

How is false self-employment presented?

2.9 It is a relatively simple matter to present an engagement as self-employment. In many instances there is no written contract setting out the terms of the engagement; the engagement is simply labelled as one of self-employment. In addition, there are specialist advisory firms who provide contracts which, they claim, contain all that is needed to be classed as self-employed. This is usually achieved simply by incorporating a number of employment case law factors,

¹ An explanation of CIS is given at paragraph 2.16

²[2009] UKFTT 53 (TC)

particularly the right of substitution. In many cases, these contract terms bear little resemblance to the actual conduct of the work or the conditions under which it is carried out.

Box 2.B: Extracts from contracts presenting the engagement as self-employment

“The contractor intends that in this working relationship you are an independent subcontractor.”

“Both parties agree that they do not intend to create or imply any mutuality of obligations either during or in between any individual engagement.”

“You have the right to send someone with similar experience and qualifications in your place.”

Source: HMRC Compliance activity

2.10 Where both the worker and the engager decide that self-employed status is the desired outcome, then it is very challenging for HMRC to build a full and accurate picture of the true terms of the engagement. As a result, demonstrating any mismatch between the contract and the reality can be difficult and time-consuming. Or, if there is no written contract in place, establishing the actual terms of the engagement can also be problematic.

Box 2.C: Case study example of difficulties encountered by HMRC

In one case, HMRC reviewed the employment status of workers who were engaged as plant operatives on a self-employed basis and concluded that the workers should have been treated as employees. As the engager did not agree, the intention was that the appeal would be heard before the Tribunal Judges. The engager decided to engage a specialist adviser, who presented new evidence which contradicted that previously put forward by the engager and his previous agent. In particular, the adviser produced invoices from the workers that did not reconcile to the returns submitted to HMRC by either the engager or the worker. Due to the contradictions in the evidence, the difficulties in establishing the actual facts and the time and costs that would be involved, HMRC decided that it would not be worthwhile to pursue the matter further.

Source: HMRC compliance activity

Growth in the use of intermediaries

2.11 In recent years, increasing numbers of workers in the construction industry have been providing their services through intermediary structures: both based within the UK and outside the UK. Employment Agencies³ may also place workers with an engager through these structures. These intermediaries take a number of forms and include:

Limited companies

2.12 Workers, including those who are genuinely in business on their own account, may decide to incorporate, for example, to benefit from limited liability.

³ Employment Agency in this document is used to refer to an agency which supplies workers to end clients to work under their direction and remains part of the ongoing relationship between the worker and end client, technically known as an “employment business”. This differs to an introduction agency known as an “employment agency”. These terms are defined in the Employment Agencies Act 1973, as amended by the Employment Relations Act 1999.

Umbrella companies

2.13 Workers may decide to provide their services, usually to an Employment Agency in the first instance, through an umbrella company. This has the potential advantage of providing the worker with some employment rights and can allow workers to benefit from favourable income tax and NICs treatment of the expenses they incur in travelling to sites.

“Self-employed model”

2.14 In some cases the intermediaries are set up with the intention of ensuring that the worker has self-employed status. These intermediaries often hold themselves out to be contractors within the meaning of the CIS. This is because they purport to provide labour within the construction industry. In most cases, the reality of the situation is that the worker finds their own work and the intermediary simply provides a vehicle through which the income from this work can be routed. The intermediary treats the worker as self-employed and makes payments to the worker on this basis. In this way, at no point in the payment chain are PAYE or NICs accounted for.

2.15 The services of intermediaries are widely advertised, emphasising the tax and NICs savings of self-employed status. The following are some examples from websites:

Box 2.D: Website advertising to engagers

How to make the switch from PAYE to CIS

The main benefits of working on a self-employed basis, for the operatives, are that they pay less tax and national insurance. They take home more of their gross pay which is a fact that should be emphasized.

How do I sell this to the workforce?

The best way of selling this is simply to show the operatives the numbers. Someone on a weekly gross of £600 would take home £449 on PAYE, and £480 on CIS.

If your workforce is currently on PAYE, you'll make a typical saving of £130+ . Every week.

Box 2.E: Website advertising to Employment Agencies

In most cases, employment agencies can only deal with sub-contractors on an employed basis. Where the worker is working as a sub-contractor direct with another contractor, a long-term assignment could result in their status being perceived as employed, in which case they may be forced to go PAYE. Either way, XXXXX will maintain the worker's self-employed status.

Box 2.F: Website advertising aimed at workers

Want To Stay Self Employed?

Self-employed subcontractors engaged by us are able to avoid the limitations of both PAYE and the costs of running a limited company.

Under the Isle of Man tax regime we can quite properly make payments to self-employed subcontractors who work in the UK without any prior deductions for Tax or National Insurance.

The Construction Industry Scheme (CIS)⁴

2.16 Since the 1970s there has been a special arrangement in place for the construction industry. This operates so that a deduction on account of tax is made from payments to companies, businesses and individuals providing construction services unless certain conditions are met.

2.17 The existence of the CIS should not have any impact on the decision that has to be taken by the engager regarding a worker's status. It is clear that the CIS legislation does not apply if the worker is engaged under employment terms. The fact that an individual worker is registered under the CIS is not confirmation that he should be treated as self-employed for income tax and NICs. This will depend on the facts and the application of the tests.

⁴ Sections 55 to 57 of, and schedules 11 and 12 to Finance Act 2004

3

What problems does false self-employment cause?

3.1 The problems that false self-employment causes can be summarised as follows:

- for the industry, an unfair competitive advantage for those businesses who disregard their Pay as You Earn (PAYE) and National Insurance (NICs) obligations when they engage workers and a corresponding disadvantage for those businesses which properly engage their workers as employees;
- for the worker, a loss of entitlement to Jobseekers Allowance and Secondary State Pension and a lack of long term job security and career opportunities; and
- a risk to the Exchequer, as the correct amount of income tax and NICs is not being paid.

The industry

3.2 Certain sections of the industry itself have long complained of the willingness of certain engagers to hire workers, for income tax and NICs purposes, on a self-employed basis, when the reality of the engagement is one of employment. This gives those engagers an unfair commercial advantage over those who correctly apply the rules, by avoiding the payment of employer's NICs and consequently offering higher pay rates. It also distorts the labour market by attracting away those workers prepared to opt for the short-term financial benefits of being treated as self-employed, such as the better pay rates and the more advantageous tax and NICs regime.

3.3 Furthermore, false self-employment may also contribute to a culture of employers neglecting their wider responsibilities in accordance with employment law. There is also a risk of a failure by the industry to invest adequately in training and skills for the future.

The worker

3.4 Some workers are given no choice as to the terms of the engagement. They are either required to accept "self-employment" with the engager or may be obliged to work through an intermediary and are treated by the intermediary as being self-employed. This may well be against their long-term interests, depriving them of entitlement to state benefits. Others are willing to acquiesce in the appearance of being self-employed as they wish to take advantage of the short-term financial benefit of paying less tax and NICs.

Risk to the Exchequer

3.5 As noted in paragraph 2.3, the use of false self-employment results in less tax and NICs being paid by the worker and no employer's NICs being paid by the engager. The cost to the Exchequer of less tax and NICs being paid as a result of false self-employment is estimated to be in the region of £350m per annum.

3.6 As noted in paragraph 2.6, it is likely that those subcontractors operating as sole traders (estimated to number 300,000 in 2007/08), with no claims for deductions for the cost of plant, equipment nor materials, were engaged on employment terms. These figures do not include

subcontractors who may provide their services through an intermediary or personal service company.

3.7 The Government's previous estimate had put the potential number of subcontractors who were falsely self-employed at 200,000. Professor Mark Harvey of Essex University in his report, "The Evasion Economy - False Self-employment in the Construction Industry", stated that the number of workers affected by false self-employment was approximately 400,000. As indicated above, the further detailed analysis that has now been carried out suggests that the actual number may be somewhere between the figure put forward by Professor Harvey and the Government's original estimate.

4

What action has been taken in the past?

Previous measures to encourage voluntary compliance

4.1 False self-employment has long been identified as a problem and considerable effort has been made to assist engagers, and in particular those within the construction industry, to get employment status right. However, despite these measures, there has been no obvious lasting reduction in the problem of false self-employment in the construction industry.

Employment Status Indicator tool (ESI)

4.2 HM Revenue and Customs (HMRC) have made available the online Employment Status Indicator tool, which provides engagers with an opinion on their workers' status based on the facts they input to the tool. Furthermore, provided the facts input are accurate, HMRC have stated that they are prepared to accept the opinion provided by the tool as binding on HMRC. As such, the tool not only assists employers with what can sometimes be a complex decision making process, but also provides a significant degree of certainty that the correct decision has been reached.

Moratorium

4.3 In 1997, the then Contributions Agency and Inland Revenue granted a moratorium. Providing engagers took steps to ensure their workers were correctly categorised, no recovery action was taken for any income tax and National Insurance (NICs) that might have been underpaid in previous periods due to mis-categorisation. This moratorium resulted in the movement of approximately 180,000 workers in the industry from self-employment to employment. However, in the following few years, some of those workers moved back to self-employment.

Restructuring of compliance activity by HMRC

4.4 Despite the initial success of the moratorium, it became clear that this had not fully dealt with the problem of false self-employment. In 2004/05 the then Inland Revenue sought to address this problem by restructuring its compliance activity. Additional staff were deployed in specialist construction industry compliance teams with a specific remit of addressing this problem. However, it became clear that compliance activity on its own could not provide a solution.

Letters to engagers and subcontractors

4.5 Throughout 2004/05 and 2005/06 the then Inland Revenue attempted to encourage compliance by sending targeted letters to engagers to remind them of their responsibility to determine the correct employment status of workers. This afforded engagers an opportunity to rectify voluntarily any mis-categorisation of workers, prior to direct compliance activity. This measure may have persuaded some to comply but has had a limited positive impact.

Declaration on the Construction Industry Scheme (CIS) return

4.6 In 2007 a declaration was included in the new CIS return, requiring confirmation that proper consideration had been given by the engager to the status of the workers shown on the return as being self-employed. The purpose of this question was to serve as a reminder to the industry of their obligations as employers and was an opportunity for the industry to take stock and regulate its behaviour. This has had a positive effect on some engagers in changing behaviour but evidence shows that it had the opposite effect on other engagers, who have taken steps to protect the arrangements that they have in place, for example, by engaging workers through intermediaries.

Conclusions

4.7 While some of these measures have had a positive effect, this has tended to be temporary or confined to a small number of cases. There has been no significant lasting effect on levels of false self-employment within the industry. Measures designed to encourage voluntary compliance have in some cases resulted in workers and engagers seeking other ways to disguise employment, which is evidenced by the growing use of intermediary structures. The only option currently available to tackle this problem is for HMRC to carry out an increasing number of compliance reviews.

4.8 The Government has concluded that deploying a significantly higher level of compliance activity for this industry compared to others, with the additional cost of resources that would be involved, is not a viable long-term solution. In any case, further compliance activity by itself may not be sufficiently effective, given the increasing use of intermediaries. Instead the Government believes that legislation to deem income received by workers in the construction industry to be employment income is the best way to tackle this problem. Details of how this might work are set out in Chapter 5.

5

The proposed solution

“Deeming” employment income

5.1 The Government believes that the introduction of legislation, which moves away from the current case law approach and applies specific criteria to the engagement of workers in the construction industry, is the best way to address the issue of false self-employment.

5.2 The Government is seeking to design a solution for the construction industry which would ensure that those who are receiving payments for engagements that in reality amount to employment have the correct amount of income tax and National Insurance (NICs) applied to those payments. It would not define employment or self-employment for tax and NICs more generally, or for employment law.

5.3 There is a major reliance on subcontracting within the construction industry and this means that a range of contractual arrangements are entered into, some of which are complex. For most non-housing projects, main contractors will bid for work on the basis of a fixed price, subcontracting the delivery of much of the work. Specialist subcontractors, in turn, further subcontract work so that, for any particular project, a number of tiers of subcontractors are likely to be involved. By contrast, the housing sector is characterised by the existence of developers who buy land and build homes speculatively. The workforce is similarly diverse, with highly skilled specialists and tradesmen through to labourers. However, in most cases there are fewer subcontracting tiers than in general construction. This reliance on sub-contracting means that often Employment Agencies are used to source workers and therefore play an important part in the supply of labour. Any legislation will need to take account of the contractual arrangements used by the industry.

When would it apply?

5.4 The Government proposes that, where a person, (“the engager”) whose main business involves the carrying out or commissioning of “construction operations” (as defined for the purposes of the Construction Industry Scheme (CIS)¹), uses the services of a worker to carry out such operations, then the payment received in respect of those services will be deemed to be employment income. This deeming will occur unless the worker fulfils one of three statutory criteria. Any payment made to the worker which is deemed to be employment income will be subject to Pay as You Earn (PAYE) and NICs.

5.5 It is the activity that the worker is actually performing for the engager to which the criteria would be applied, regardless of who pays the worker. As outlined above, for the deeming provision to apply, the main business of the engager must involve the carrying out or commissioning of construction operations. If this is not the case, for example, where the worker is providing his services to a householder for work on a domestic property, then the deeming provision will not apply.

¹ S74 Finance Act 2004

Who would apply the test?

5.6 Although it is the work done for the engager that is relevant for the deeming provision, the person responsible for making the payment to the worker ("the payer") will have to apply the statutory criteria. The payer could be the engager, an Employment Agency or intermediary. The payer will also have responsibility for applying PAYE and NICs to the amount of employment income and accounting for employer's NICs.

The benefits

5.7 The introduction of a deeming provision in legislation means that:

- it is clear who has responsibility for applying the statutory criteria which determine whether the worker's income is to be treated as employment income and applying PAYE and NICs; and
- the facts and circumstances of the engagement are key, rather than the contractual terms that are presented.

Principles underlying the deeming criteria selected

5.8 It is critical that the criteria used to deem when a worker's income is treated as employment income are objective, simple and easy for the payer to apply. The reason for the decision reached through the application of the criteria should be clear to both the worker and the payer.

5.9 It is also important that the criteria should not be capable of manipulation.

5.10 The purpose of the legislation is not to deem a worker's income to be employment income where it is clear that the worker is carrying on a business and would otherwise be treated as self-employed. Therefore, it is important that the application of the criteria give, as far as possible, a fair and reasonable outcome.

The criteria

5.11 The Government believes that the following three criteria meet those requirements and are reliable indicators, within the context of the construction industry, of a worker being in receipt of self-employment income:

1. **Provision of plant and equipment** – that a person provides the plant and equipment required for the job they have been engaged to carry out. This will exclude the tools of the trade which it is normal and traditional in the industry for individuals to provide for themselves to do their job;
2. **Provision of all materials** – that a person provides all materials required to complete a job; or
3. **Provision of other workers** – that a person provides other workers to carry out operations under the contract and is responsible for paying them.

5.12 A worker will have to meet one or more of these three criteria in order not to be deemed to be in receipt of employment income.

5.13 The Government believes that these criteria bear the hallmarks of a person genuinely carrying on a business on his own account, that is:

- having invested in the plant and equipment necessary to carry out the contract;
- sourcing and supplying the materials for the contract; or
- engaging additional labour for the fulfilment of the contract and being responsible for the engagement and payment of that labour.

5.14 In the context of the construction industry, each of these criteria represents a significant element of a contract. The Government believes that if the tests developed by the courts to determine a worker's status for income tax and NICs purposes were applied instead of the deeming provision, then the presence of one of these criteria would be sufficient to indicate self-employment.

5.15 In weighing up the criteria that could be used, the Government wishes to avoid those that would introduce unnecessary levels of complexity or uncertainty. The Government believes that these three criteria meet this objective.

5.16 Box 5.A illustrates how the deeming provision would work.

Box 5.A: ABC Ltd – how 'deeming' would work

ABC Ltd is a business, which undertakes development of sites across the country for private housing. It secures most of the required building services locally at the different locations, rather than having a permanent workforce. For the current project, it is building six houses on a small site.

The company enters into various contracts to have work carried out on the site, as follows:

Carrying out groundwork

Mr B supplies his own services and those of three other men for the groundwork. The payments made to Mr B will **not** be deemed to be employment income, as he meets criterion 3. However, if he does not already employ the three people working for him, he will need to treat them as being deemed to be in receipt of employment income if they meet none of the criteria.

Building the walls

Four people are engaged by ABC Ltd for bricklaying. ABC Ltd sources all the bricks and the bricklayers bring only their tools of the trade. They **will** be deemed to be in receipt of employment income, because they meet none of the criteria.

Installing the glazing

Mr C supplies and fits the glazing with the assistance of his employee. Mr C will **not** be deemed to be in receipt of employment income, as he meets criteria 2 and 3.

Fixing the roofing

Four people are engaged for installing the roofing sourced by ABC Ltd. They do not bring any equipment with them. They will be deemed to be in receipt of employment income, because they meet none of the criteria.

Installing the fixtures and fittings

Two people are engaged to fit all the doors, cupboards and other fittings, which have been sourced by ABC Ltd, bringing with them only their own tools of the trade. They will be deemed to be in receipt of employment income, because they meet none of the criteria.

CIS returns

Where workers engaged by ABC Ltd are not deemed to be receiving employment income they will be included on ABC Ltd's CIS return.

The amount to which PAYE and NICs will be applied

5.17 Where the person in receipt of the worker's services and the payer are the same, or the payer is an Employment Agency, PAYE and NICs will be due on the full amount of the payment. Employer's NICs will also be payable on the full amount. Where the payer is an intermediary, then the definition of payment in the Managed Service Company legislation (Chapter 9, Part 2 Income Tax (Earnings and Pensions) Act 2003 and Social Security Contributions (Managed Service Companies) Regulations 2007 (SI 2007/2070)) may be adopted.

5.18 As outlined at paragraph 5.6 above, the person who makes the payment to the worker will have the obligation to apply the statutory criteria. Where one of these criteria is not met, the payer has to treat the income as employment income (to the extent that it is not already treated as such) and operate PAYE and NICs.

The payer

5.19 The engagement being carried out by the worker may not necessarily be "for" the payer, but the payer will have to ensure that he has sufficient information to apply the criteria. In the absence of information or evidence to apply the criteria, the default position will be that income will be deemed employment income. The compliance requirements imposed on employers by the PAYE and NICs legislation will also apply to payers.

5.20 There are other parts of the PAYE and NICs legislation where a worker is deemed to be in receipt of employment income where there may not be an employee/employer relationship. It is necessary to consider how these other provisions will interact with this deeming provision for the construction industry.

Payer is a personal service company

5.21 Where a worker provides their services through their own company which they control, sometimes termed a personal service company, the deeming provision for construction will take precedence over the intermediaries legislation (IR35).² This means that the worker's personal service company must first consider the deeming legislation and, only if this does not apply, go on to consider the intermediaries legislation in respect of any payments.

² Chapter 8, Part 2 Income Tax (Earnings and Pensions) Act 2003 and Social Security Contributions (Intermediaries) Regulations 2000 (SI 2000/727)

Payer is a managed service company

5.22 Where a worker provides their services through a Managed Service Company³, the Managed Service Company legislation will take precedence over the deeming legislation for construction.

Payer is an Employment Agency

5.23 Where a worker is placed with an end client by an Employment Agency, the deeming legislation will take precedence over the Agencies legislation.⁴

5.24 This means that the Agency must first consider the deeming legislation and only consider the Agency legislation in respect of any payments to which the deeming legislation does not apply.

Compliance

5.25 It is the intention that an HMRC compliance programme would accompany the introduction of the deeming provision. The purpose of this would be to help payers understand how the provision applies and to ensure that there is proper compliance by the industry.

Timing

5.26 The Government recognises that getting the timing right for the implementation of the proposed solution is critical and will take into consideration representations made on this point.

Questions for consultation: the deeming criteria

5.27 The Government is keen to ensure that the proposed legislation operates as intended and, in particular, that the deeming criteria are simple and easy to apply.

5.28 Question 1: **Do these three criteria represent fair indicators of a person who is running his own business and is therefore genuinely self-employed?**

5.29 Question 2: **Are there other indicators which ought to be considered for inclusion?**

5.30 Question 3: **Are there instances where none of the criteria are met, but a worker would, by reference to the usual case law tests in respect of the true terms of an engagement, otherwise be treated as self-employed? If so, please provide examples.**

5.31 Question 4: **VAT registration can signal that the worker is in business on his own account, buying materials and investing in plant which takes the turnover of the business over the threshold for registration. Would it be helpful to include the additional requirement of VAT registration? This would mean that the worker would need to meet one of the three specified criteria and would also have to be registered for VAT.**

5.32 Question 5: **Is the payer the correct person to have the responsibility for applying the criteria and operating PAYE and NICs?**

³ as defined in Chapter 9, Part 2 Income Tax (Earnings and Pensions) Act 2003 and Social Security Contributions (Managed Service Companies) Regulations 2007 (SI 2007/2070)

⁴ Chapter 7, Part 2 Income Tax (Earnings and Pensions) Act 2003 and Social Security (Categorisation of Earners) Regulations 1978 (SI 1978/1689)

6

What impact will this have?

Administrative burdens

6.1 Using a set of simple criteria ought to minimise the cost of complying with the legislation. Where businesses within the industry are currently complying with their obligations, applying these criteria may help to streamline the decision making process.

6.2 The introduction of the deeming provision is intended only to apply to those workers who would in any case be considered to be employees if the existing case law tests had been properly and diligently applied. Therefore it is unlikely that Pay as You Earn (PAYE) and National Insurance (NICs) will now have to be applied in cases where individuals are properly in business on their own account. As a result, the deeming provision should not introduce administrative burdens additional to those which already exist if there were proper compliance.

6.3 It is envisaged that where workers would under the proposal be deemed to be in receipt of employment income, nearly 60 per cent of payers will already be operating PAYE schemes for other employees. Therefore, for these payers, the costs of processing additional payments through the payroll are likely to be small. In addition, if, as is likely to be the case, the workers were treated as self-employed then the payments would have been dealt with under the Construction Industry Scheme (CIS).

6.4 The Government recognises that some small businesses (40 per cent) who are not already operating a payroll and who have to apply the deeming provision are micro. In addition, small businesses may find accounting for PAYE and NICs a significant additional burden. This is more likely to be the case where the small business engages only one or two workers for short periods on a sporadic basis. The need to operate the necessary starter and leaver processes on a frequent basis will increase the administrative burden for these businesses.

Question for consultation

6.5 Question 6: **Are there instances where the introduction of the deeming provision could bring about a significant additional administrative burden? If so, please give examples.**

Labour market

6.6 The proposal may increase the cost of labour to construction firms, resulting in either an increase in pre-tax wages or a decrease in post-tax wages or some combination of the two when engaging workers which are subject to deeming. The dominant effect is thought likely to be a decrease in post tax wages as income taxes are for the most part passed on in full to the type of workers affected. In the Government's view, the effect of the decrease in wages would be to reduce the number of people willing to work in construction at the lower wage meaning the impact of the measure would be shared between workers and employers.

6.7 Britain's labour market is characterised by its adaptability and flexibility. There are a wide variety of patterns and types of work available and this provides individuals with more choice about how they want to work and gives businesses the flexibility to respond quickly to new opportunities when they arise. Contractors who value the flexibility of Agency or contract

workers will still be able to use them in this way and those who are genuinely self-employed will be able to continue to operate in this way. This proposal will restore a level playing field for those businesses that are complying fully with their responsibilities. They will no longer be undercut by those who, up until now, have not chosen to comply.

6.8 Labour market flexibility is a key feature of the construction industry, not least because output and employment in the sector is particularly cyclical. The self-employed are likely to be among the most flexible element of the labour force as they can be more readily taken on or let go in response to changing demand conditions. The reduction in the number of self-employed workers could therefore have an impact on the flexibility of the labour market. It is important to bear in mind, however, when considering the likely level of this impact that the deeming proposal will only affect employment status from the point of view of tax and NICs liabilities, and not for employment law purposes. Accordingly, any other perceived benefits of engaging workers on a self-employed basis may remain.

6.9 Overall, labour and product market efficiency will benefit from the removal of two distortions to competition: first, between firms within the construction industry who use false self-employment and those that do not, and second, between the construction industry as a whole and other industries where using false self-employment is not widespread. Removing these artificial benefits to the construction industry will level the playing field, allowing labour in the economy to be allocated more efficiently.

Question for consultation

6.10 Question 7: **Are there occasions when the deeming provision could impact on the adaptability and flexibility of the labour market? If so, please provide examples.**

Avoidance

6.11 There is no doubt that efforts will be made to circumvent the proposal, including by routing payments through various intermediary structures, whether in the UK or outside the UK. The proposed legislation would contain provisions to counter such arrangements.

6.12 The use of intermediary companies to avoid income tax and NICs liabilities is not new. This, allied to the fact that several parties in the contractual chain have a financial vested interest in enabling a worker to be classed as self-employed, raises the issue of how best to protect the Exchequer by countering wilful attempts by various parties to circumvent the legislation. One option could be to extend the provisions of S688A ITEPA (Managed Service Company transfer of debt provisions) to apply in specified circumstances where the deemed employment income proposals give rise to an irrecoverable PAYE and NICs debt from the payer.

6.13 In addition, in relation to any offshore arrangements, S689 ITEPA 2003 and Social Security (Categorisation of Earners) Regulations 1978 may impose a PAYE and NICs obligation on the business that the worker is “working for” in the UK.

Question for consultation

6.14 Question 8: **What avoidance routes might be available and how should these be countered?**

7

Summary of questions and the consultation process

Summary of Questions

7.1 The Government would welcome views on the proposals outlined in this Consultation Document and, in particular, on the questions which have been set out in the document, which are also summarised below:

Chapter 5: The Solution being proposed

Question 1: Do these criteria represent fair indicators of a person who is running his own business and is therefore genuinely self-employed?

Question 2: Are there other indicators which ought to be considered?

Question 3: Are there instances where none of the criteria are met, but a worker would, by reference to the usual case law tests in respect of the true terms of an engagement, otherwise be treated as self-employed? If so, please provide examples.

Question 4: VAT registration can signal that the worker is in business on his own account, buying materials and investing in plant which takes the turnover of the business over the threshold for registration. Would it be helpful to include the criteria of VAT registration, which would need to be met in addition to one of the three other criteria?

Question 5: Is the payer the correct person to have the responsibility for applying the criteria and applying Pay as You Earn (PAYE) and NICs?

Chapter 6: What impact will this have?

Question 6: Are there instances where the introduction of the deeming provision could bring about a significant additional administrative burden? If so, please give examples.

Question 7: Are there occasions when the deeming provision could impact on the adaptability and flexibility of the labour market? If so, please provide examples.

Question 8: What avoidance routes might be available and how should these be countered?

Process and timetable for consultation

7.2 Comments on this consultation should be sent by 12 October 2009 to:

Lisa Fitzpatrick
False self-employment in the construction industry consultation
Personal Tax Team
HM Treasury, 2/SE
1 Horse Guards Road
London
SW1A 2HQ
Or e-mail: construction.consultation@hm-treasury.gov.uk
Telephone queries: 0207 270 5330

About the consultation process

7.3 This consultation has been conducted in accordance with the Government's consultation criteria. If you wish to access the full version of the Code, you can obtain it at:

<http://www.berr.gov.uk/whatwedo/bre/consultation-guidance/page44420.html>

Box 7.A: The consultation criteria

1. When to consult - Formal consultation should take place at a stage when there is scope to influence the policy outcome.
2. Duration of consultation exercises - Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
3. Clarity of scope and impact - Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
4. Accessibility of consultation exercise - Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
5. The burden of consultation - Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
6. Responsiveness of consultation exercises - Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
7. Capacity to consult - Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

If you feel that this consultation does not satisfy these criteria, or if you have any complaints or comments about the process, please contact:

Richard Bowyer
Better Regulation Unit
100 Parliament St
London
SW1A 2BQ
020 7147 0062 or richard.bowyer@hmrc.gsi.gov.uk

Confidentiality disclosure

7.4 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004).

7.5 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

7.6 The Department will process your personal data in accordance with the DPA and in the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.



Impact Assessment

Impact Assessment follows overleaf.

Summary: Intervention & Options

Department /Agency: HM Treasury	Title: False self-employment in construction: taxation of workers	
Stage: Consultation	Version: 1	Date: 13 July 2009
Related Publications:		

Available to view or download at:

http://www.hm-treasury.gov.uk/consult_fullindex.htm

Contact for enquiries:

Lisa Fitzpatrick

Telephone:

0207 270 5330

What is the problem under consideration? Why is government intervention necessary?

There is evidence of false self-employment within the construction industry. False self-employment is where an engager (a person who engages a worker) treats a worker as self-employed even though he is engaged to perform work in circumstances consistent with employment terms.

For the industry, false self-employment creates an unfair competitive advantage for those businesses who do not comply with their Pay As You Earn (PAYE) and National Insurance Contributions (NICs) obligations, as their costs will be lower. For the workers, false self-employment results in a loss of entitlement to state benefits and reduced job security and career opportunities. For the Exchequer, there is a risk to PAYE and NICs.

What are the policy objectives and the intended effects?

The Government wishes to address the problems outlined above by introducing legislation which deems construction workers to be in receipt of employment income unless one of three criteria is met. The Government's objective is to develop a workable legislative solution, which is fair, clear and easy to apply and ensures that those workers who are receiving payments for engagements that in reality amount to employment pay the correct amount of income tax and NICs. The introduction of such a deeming provision should increase the competitiveness of those firms that are currently complying with their obligations for PAYE and NICs.

What policy options have been considered? Please justify any preferred option.

The options that have been considered are:

- No change - continue with the status quo; or
- Deem workers in construction to be in receipt of employment income for tax & NIC purposes, unless one of three criteria is met, with the criteria to be applied by the person responsible for paying the worker ("the payer). Having HMRC, instead of the payer, apply the criteria was also considered.

The preferred option is for the criteria to be applied by the payer. This levels the playing field for construction businesses and minimises the increase in the administration burden for them.


When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

HMRC will conduct a review within 3 years after the introduction of the changes.

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:



.....Date: 13 July 2009

Summary: Analysis & Evidence

Policy Option: 1

Description: Continue with the status quo

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' There are no changes in administrative burdens or wider compliance costs.	
	One-off (Transition)	Yrs		
	£ 0			
	Average Annual Cost (excluding one-off)			
	£ 0		Total Cost (PV)	£ 0
Other key non-monetised costs by 'main affected groups' There are no changes to monies paid to the Exchequer as it is assumed false self-employment will continue at the current level.				

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' There are no changes in administrative burdens or wider compliance costs.	
	One-off	Yrs		
	£ 0			
	Average Annual Benefit (excluding one-off)			
	£ 0		Total Benefit (PV)	£ 0
Other key non-monetised benefits by 'main affected groups' Construction businesses with a largely falsely self-employed workforce enjoy a competitive advantage over those who do not because they suffer lower costs of PAYE and NICs				

Key Assumptions/Sensitivities/Risks There is an existing Exchequer loss of around £350 million per annum from false-self employment in the construction industry. There is a risk that this Exchequer loss could grow over time if false self-employment increases.

Price Base Year 2009	Time Period Years 5	Net Benefit Range (NPV) £ 0	NET BENEFIT (NPV Best estimate) £ 0
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What is the geographic coverage of the policy/option?			United Kingdom		
On what date will the policy be implemented?					
Which organisation(s) will enforce the policy?			HMRC		
What is the total annual cost of enforcement for these organisations?			£ 0		
Does enforcement comply with Hampton principles?			Yes		
Will implementation go beyond minimum EU requirements?			Yes		
What is the value of the proposed offsetting measure per year?			£ 0		
What is the value of changes in greenhouse gas emissions?			£ 0		
Will the proposal have a significant impact on competition?			No		
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large
Are any of these organisations exempt?		No	No	No	No

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)		
Increase of	£ 0	Decrease of	£ 0	Net Impact	£ 0

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Summary: Analysis & Evidence

Policy Option: 2

Description: Deem all workers in construction to be employed for tax & NIC purposes, unless one of three criteria is met, with these criteria to be applied by the payer

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' One-off transitional costs arise from contractors becoming familiar with the new legislation and amending their systems. An increase in the on-going administrative burden arises from contractors treating payments to the falsely self-employed as employment income.
	One-off (Transition)	Yrs	
	£ 50m - 60m	1	
	Average Annual Cost (excluding one-off)		
	£ 32m		Total Cost (PV) £ 210 m -220 m
Other key non-monetised costs by 'main affected groups' Payers and falsely self-employed workers would have to pay PAYE and NICs on income. The yield to the Exchequer would be subject to behavioural responses from the legislation and has not been assessed.			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' Payments to the falsely self-employed would not be made through the construction industry scheme (CIS). Hence there is a decrease in the administrative burden arising from CIS.
	One-off	Yrs	
	£ 0		
	Average Annual Benefit (excluding one-off)		
	£ 38 m		Total Benefit (PV) £ 190 m
Other key non-monetised benefits by 'main affected groups' Distortions in the labour market between the construction industry, who can disguise employees as false self-employed sub-contractors, and other industries in which false self-employment is not prevalent.			

Key Assumptions/Sensitivities/Risks Costs and benefits are presented as ranges as the precise impact on businesses cannot be assessed until draft legislation is available. There are potential behavioural factors associated with deeming of sub-contractors which may mean the Exchequer yield from introducing legislation is less than the current estimated Exchequer loss.

Price Base Year 2009	Time Period Years 5	Net Benefit Range (NPV) £ -20 m to -30 m	NET BENEFIT (NPV Best estimate) £ -25m
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What is the geographic coverage of the policy/option?	United Kingdom			
On what date will the policy be implemented?	tbc			
Which organisation(s) will enforce the policy?	HMRC			
What is the total annual cost of enforcement for these organisations?	£ 0			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	No			
What is the value of the proposed offsetting measure per year?	£ 0			
What is the value of changes in greenhouse gas emissions?	£ 0			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	No	No

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)	
Increase of	£29 m	Decrease of	£ 34 m
		Net Impact	£ -5 m

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

Background

Where false self-employment occurs, workers and engagers are able to benefit from a more advantageous tax and NICs regime than would have been the case if the worker were engaged on employment terms.

For tax and NICs purposes workers provide their services either on a self-employed basis or an employed basis. A series of tests have been developed through case law and these include looking at whether:

- supervision and control is exercised by the engager;
- whether the worker bears financial risk; and
- whether the worker is in business on his own account.

These are applied in order to determine whether, looking at the facts and circumstances and the terms of the engagement, the worker should be treated as employed or self-employed. The engager has an obligation under the PAYE and NICs legislation to consider the status of a worker by applying these tests.

False self-employment occurs where the underlying characteristics of the relationship are employment but the engagement is presented as self-employment. This is primarily driven by the differences in the tax and NICs treatment of the self-employed and employed. These are, for self-employed workers, the potential to claim deductions for expenditure against income, which would not be available for employees and the reduction in NICs payable by the individual. In addition, where a worker is self-employed, employer's NICs is not payable, which benefits the engager. Accordingly, both workers and engagers have a financial incentive to attempt to portray their employment income as self-employment income in order to reduce their tax and NICs liabilities.

There is clear evidence that false self-employment is a problem in the construction industry and that it has existed for a number of years. This evidence includes complaints from within sections of the industry that certain engagers are prepared to take on workers on a self-employed basis, even though the reality of the engagement is one of employment. In addition, it is clear that the proportion of self-employed labour, compared with employed labour is much higher in the construction industry than in other business sectors. It appears that around one third of construction workers are providing only their labour to the engager and it must be likely that a significant proportion of these would in fact be providing their services on employment terms. HMRC compliance activity also confirms that the use of false self-employment is prevalent in the industry.

Recent years have also seen the growth of specialist advisory firms who provide contracts which, it is claimed, contain all that is needed to be classed as self-employed. This is usually achieved by simply incorporating a number of employment case law factors. In many cases, these contracts bear little resemblance to the actual conduct of the work or the conditions under which it is carried out.

There has also been a growth in intermediaries operating within the construction sector: both based within the UK and outside the UK. These intermediaries often hold themselves out to be contractors within the meaning of the Construction Industry Scheme (CIS). This is because they purport to provide labour within the construction industry. In most cases, the reality of the situation is that the worker finds their own work and the intermediary simply provides a vehicle through which the income from this work can be routed. The intermediary pays the worker as self-employed although the relationship between worker and intermediary is rarely clearly defined. In this way, at no point in the payment chain is PAYE or NIC accounted for.

HMRC has taken steps over a number of years to address the problem of false self-employment by trying to encourage voluntary compliance including a moratorium granted by the then

Contributions Agency and Inland Revenue for those operating in the industry and trying to raise awareness of the issue. HMRC have also re-structured and increased their compliance activity. However, where both the worker and the engager perceive that self-employed status is very much the desired outcome, this can then prove to be a very challenging environment for HMRC to be able to build a full and accurate picture of the terms of the engagement. Overall, these measures have not achieved the desired outcome and levels of false self-employment within the industry continue to be high. The conclusion has been reached that compliance activity and the encouragement of voluntary compliance is not an effective way of tackling the problem of false self-employment in the long term.

In order to tackle the ongoing problem of false self-employment within the construction industry the Government believes that workers in construction, whether acting as a sole trader or through a partnership or company, should be deemed to be in receipt of employment income for tax and NICs purposes (“deeming”) unless one of three criteria is met. The Government believes that the following three criteria are reliable indicators, within the context of the construction industry, of a worker being in receipt of genuine self-employment income:

- Provision of plant and equipment – that a person provides the plant/equipment required to complete a job (not just tools of the trade);
- Provision of all materials – that a person provides all materials required to complete a job;
- Provision of other workers – that a person provides other workers to carry out operations under the contract.

The person responsible for paying the worker (“the payer”) would apply the criteria. This could be the engager, an Employment Agency or intermediary.

The Government has concluded that having the criteria applied by HMRC would be impractical. The onus would be on the engager or the payer to provide information and evidence to HMRC in order for HMRC to be in a position to apply the criteria. Providing this information would be both onerous and time consuming for the engager or payer. Also, where there are short engagements, HMRC may not be in a position to communicate its decision to the payer before the engagement has ended. This could then lead to unfairness for the worker who, by default, would be deemed to be receiving employment income but may in fact meet one of the criteria and be capable of being treated as self-employed.

Rationale for Government Intervention

Fairness and economic efficiency

There is a distortion *within* the construction industry. Construction businesses that use a largely falsely self-employed workforce are currently at a competitive advantage because they do not suffer higher costs through the payment of PAYE and NICs. This is unfair for companies and workers that are correctly using an employer-employee relationship.

There is also a distortion in the labour market between the construction industry, which can disguise employees as false self-employed subcontractors, and other industries, in which false-self-employment is less prevalent. This is unfair on the other industries, as it could make working in construction more attractive than similar activities elsewhere. Workers on the margin between construction and employment elsewhere might therefore choose construction as a result of this, meaning there is an inefficient allocation of resources.

Policy objective

This consultation seeks to test our initial analysis of those who could be subject to deeming, including the number of payers and workers potentially affected, any advantages or disadvantages deeming would bring, preliminary estimates of the administrative burdens and compliance costs, and the effects on the construction sector.

Estimates of population and Exchequer costs

The following table shows the active population of contractors and sub-contractors who operated within the Construction Industry Scheme (CIS) in 2007-08.

	Number of businesses, 2007-08
Contractors only	60,000
Subcontractors only	860,000
Both contractor and sub-contractor	115,000
Total	1,035,000
All contractors	175,000
All subcontractors	975,000

Of the 860,000 businesses operating as sub-contractors only in 2007-08 some 780,000 were sole traders, 60,000 were companies and 20,000 were partnerships.

From analysis of CIS data, the Government estimates that some 300,000 of these subcontractors supplied labour only and did not supply any materials or any plant and equipment. These workers are the most likely to be falsely self-employed and not to meet any of the three criteria set out above to be in receipt of self-employment income. Some 100,000 contractors made payments to these sub-contractors in 2007-08 and could therefore potentially be directly affected under the preferred option. Some payments to sub-contractors working through companies would also be subject to deeming if none of the three criteria was met.

Assessing the potential Exchequer loss from those who are falsely self-employed is not simple. Analysis of those sole traders who appear not to fulfil any of the three criteria shows their payments through CIS has the following distribution:

Payment received by subcontractors through CIS ¹ , 2007-08, £ per year	Percentage of sub-contractors potentially subject to deeming
0 - <£5,000	24
£5,000 - < £10,000	15
£10,000 - < £15,000	13
£15,000 - < £20,000	12
£20,000 - < £25,000	11
£25,000 - < £30,000	9
£30,000 - < £35,000	6
£35,000 - < £40,000	4
£40,000 - < £45,000	2
£45,000 - < £50,000	1
£50,000 and over	2
Total	100

Using the above assumptions regarding the income distribution the loss to the Exchequer using 2009-10 tax and NIC rates is around £350 million per year. This estimate is based on the difference between tax and NICs payable on income at these levels from a self-employed worker compared with one in employment. The direct loss to the Exchequer as calculated above is not the same as the yield which would arise if legislation deeming such payments to be subject to PAYE and NICs was introduced. Potential behavioural factors such as downward

¹ Subcontractors are likely to have income from other sources either through direct employment or self-employed outside CIS.

pressure on wage rates, changes in the level of expenses claimed by workers or workers deliberately attempting to circumvent the legislation would affect the yield.

Policy options

Option 1: Allow the existing arrangements to continue unchanged

This option would allow the current framework for determining employment status in the construction industry and the resulting problems of false self-employment to continue. This remains an option if the evidence from the consultation demonstrated that there would be significant problems with the implementation of the deeming principles.

Risks

The Exchequer would continue to lose tax revenues. HMRC compliance activity suggests that there is increasing use of intermediaries which make it more difficult to establish the true nature of the engagement. This trend may continue if no action was taken. In addition, construction businesses who did not use falsely self-employed labour would continue to be disadvantaged and there would be a risk that they would start to use such a workforce. Taking no action could be seen as an endorsement by the Government that the use of a falsely self-employed workforce was acceptable.

The current distortion between the construction sector, where it is easier to hide false self-employment, and other industries could increase. For a worker, being falsely treated as self-employed may well be against their long term interests, depriving of them entitlement to Jobseekers Allowance and Secondary State Pension. False self-employment may contribute to a culture of employers neglecting their wider responsibilities including failing to invest adequately in training and skills for the future.

Considerable effort has already been made to assist businesses within the construction industry to get employment status right, e.g. encouraging voluntary compliance and redeploying additional HMRC staff in specialist construction industry compliance teams. However, this has had no significant effect on the numbers of workers who are falsely self-employed. The Government has concluded that compliance activity on its own is insufficient to address this problem.

Option 2: Deem all workers in construction to be employed for tax & NIC purposes, unless one of three criteria is met, with these criteria to be applied by the payer.

The Government would introduce primary legislation in the Finance Bill to deem workers in the construction industry to be in receipt of employment income unless one of the following three criteria applied:

- that a person provides the plant and equipment required to complete a job (not just tools of the trade);
- that a person provides all materials required to complete a job; and
- that a person provides other workers to carry out operations under the contract.

Risks

Construction businesses would face an increased cost of engaging a workforce which did not meet any of the three criteria stated above. There are several possible behavioural responses to this. They could:

- absorb the additional costs of paying PAYE and NICs;
- reduce workers' take-home pay;
- reduce the number of workers they employ;
- reduce the number of hours worked by each person; and

- employ workers through the hidden economy.

It is unclear what combination of these responses would actually be seen if this option is taken up. However, it is probable that some businesses will become less profitable, and that some workers would see a decrease in their pay. At the margins, this may cause some workers to exit the industry. The changes could decrease the flexibility of the labour market. The self-employed are the most flexible workers, since there are no costs to hire them or lay them off. However, this effect should be limited since the legislation would not affect workers' status for employment law purposes. Contractors will still be able to use Agency or contract workers and the genuinely self-employed will still be able to operate.

Costs and Benefits

HMRC is subject to quantified targets to reduce one aspect of compliance costs in particular; the administrative burden of disclosing information to HMRC or to third parties. This burden is assessed through the 'Standard Cost Model' (SCM), an activity based costing model which identifies what activities a business has to do to comply with HMRC's obligations, and which estimates the cost of these activities, including agent fees and software costs.

One-off costs

Payers would face a one-off transitional increase in their compliance costs. In 2007-08 approximately 175,000 contractors made a payment to a sub-contractor through the Construction Industry Scheme. Assuming that these contractors would become payers under the proposed deeming provision, they would need to spend time becoming familiar with any new legislation, train staff and set up new procedures to comply with legislation. The one-off transitional costs cannot be quantified accurately until the legislation is known. However, it has been assumed that an average time of 7 hours per contractor would be spent at an hourly wage rate of £26.48 in line with the Standard Cost Model, resulting in a one-off annual transitional cost of £32 million. It is assumed that there would be no one-off compliance costs for sub-contractors.

There will be a one-off cost for payers having to set up PAYE schemes. It is estimated that 43,000 payers would need to do this. All these payers would need to spend time becoming familiar with the new system, contacting HMRC and agents, training staff and setting up new procedures to comply with the new system. It is assumed that an average time of 20-30 hours per contractor would be spent at an hourly wage rate of £20.56 in line with the SCM, resulting in a one-off annual transition cost of between £20 million and £30 million. Total one-off costs are estimated at approximately £50 million to £60 million.

Ongoing costs

Under this option the Government estimates there would be a net decrease in the ongoing administrative burden faced by businesses of around £5 million per year (2005 prices). This comprises two elements, namely a reduction in the administrative burden due to removing some payments from the Construction Industry Scheme (CIS), and an increase arising from treating such payments as employment income.

Payers would need to apply PAYE and NICs to the payments received by workers deemed to be in receipt of employment income – this is likely to increase ongoing administrative burden on the payer by £29 million in 2005 prices (£32 million at 2009 prices). It has been assumed that, on average, a worker not meeting any of the three deeming criteria would have two payers per year. Therefore there would be an additional 600,000 payer/worker relationships per year subject to PAYE and NICs. Analysis suggest that some 70 per cent of these additional relationships would be where the payer has fewer than 10 employees and about 21 per cent where the payer has between 10 and 49 employees. However, just over 2 per cent of these additional relationships would be where the payer has more than 250 employees.

The analysis also suggests that around 57,000 of the payers already run a PAYE scheme for their employees and hence would experience an increase in their ongoing cost for taking up more workers. We have assumed that the ongoing cost increases by 85 per cent for micro employers (1-9 employees), 25 per cent for small employers (10-49 employees), 10 per cent for medium employers (50-249 employees) and 5 per cent for large employers (250+ employees).

However, the rest of the payers (43,000) will face the one-off cost of setting up a PAYE scheme along with the same ongoing administrative burden per worker as the existing PAYE regulations impose on businesses from the SCM.

In line with the SCM payers with more employees face a smaller increase in their administrative burden per worker as the fixed costs are spread over a greater number of workers. Making the criteria for deeming simple minimises any increase in the administrative burden of administering PAYE and NICs. It has been assumed that no taxable benefits will be provided to the worker and no taxable expenses will be paid to the worker. As such the payer will not have to provide a P11D to the workers.

Benefits

Using the SCM the ongoing administrative burden of CIS is estimated at around £100 million per annum (2005 prices). The Government provisionally estimates an ongoing reduction in the administrative burden of £34 million at 2005 prices (£38 million at 2009 prices) per year from removing some 300,000 workers from the CIS. Some 100,000 contractors would be affected and be required to make fewer payments through CIS. Reductions in the ongoing administrative burden are expected to arise from:

- fewer payments being made from payers to workers through the CIS thereby reducing the time taken by payers to complete their monthly returns, and providing statements to workers;
- a reduction in the volume and amounts of payments made by payers to HMRC through CIS;
- fewer applications from sub-contractors to register within CIS; and
- a reduction in the number of verifications of workers' status by the payer.

The current distortion in the construction industry, caused by employees being correctly paid as such in some cases, but being falsely treated as self-employed in others, would be removed. This would increase the competitiveness of those firms that are currently applying the law correctly, and would therefore 'level the playing field' for construction businesses. This in turn would also increase economic efficiency in the industry, as the price of using different firms would no longer differ for purely tax reasons.

The distortion between the construction industry, where it is currently relatively easy to disguise employment, and other industries, where it is not, would also be removed. Workers at the margins would no longer have an incentive to work in the construction industry for purely tax-saving reasons, where they might otherwise have worked in a different sector of the economy. This would lead to a more efficient allocation of resources between industries.

Small Firms Impact Test

Most contractors operating through the CIS are small businesses. The legislation applies to all construction businesses who are using a falsely self-employed workforce regardless of the business size. Small businesses must be included in the legislation as otherwise they would enjoy a competitive advantage over large businesses. The overall increase in the administrative burden is kept to a minimum by keeping the criteria for deeming simple, with the payer applying these criteria to each worker rather than HMRC.

Competition Assessment

Applying the Office for Fair Trading competition filter to the affected sectors to assess the impact of the proposed measure, it was found that an in-depth competition assessment is not warranted because the estimated impacts on competition are favourable. Taking action against those construction businesses using a falsely self-employed workforce would have a favourable impact on competition as they would pay the same levels of income tax and national insurance as those businesses who do not. Allowing false self-employment to continue would undermine the Government's efforts to create a fair environment for small business activity, by giving some businesses and individuals an unfair tax advantage over others. The preferred option should help remove this unfair advantage.

Equality Impact Tests

Gender equality impact test

The construction industry is characterised by a predominantly male workforce. The majority of workers who are falsely-self employed are male and, as such, the preferred option will affect a greater proportion of males than females. This greater proportionality reflects the degree to which gender is correlated with those workers who are falsely self-employed.

Race equality impact test

Some race specific impacts are probable reflecting the degree to which race is correlated with those workers who are self-employed. Workers from some countries such as those in Eastern Europe which joined the European Union on 1st May 2004 are more likely to work in the construction sector and hence be affected under the preferred option.

Disability

The equality impact test has been considered and there are no obvious areas for concern, but the Government would welcome feedback on this through the consultation.

Political opinion – Northern Ireland

The equality impact test has been considered and there are no obvious areas for concern, but the Government would welcome feedback on this through the consultation.

Rural specific impact test

Some rural specific impacts are also probable reflecting differences in the labour market in rural and urban areas, but only in so far as this is correlated with those workers who are falsely self-employed, and the construction businesses who use a falsely self-employed workforce.

Other specific impact tests

The other specific impact tests (see checklist) have been carefully considered and at present the Government do not foresee any significant impact, but would welcome feedback on this through the consultation. The assessments found that the changes should have no significant impact on legal aid or sustainable development. Assessments for carbon or environmental impacts or health impacts concluded that these issues are not applicable.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

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This document can be found in full on our website at:
hm-treasury.gov.uk

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