OTS Stock Take – Ch 2 PSC, employment and self-employment

In July 2020, the Office of Tax Simplification released their evaluation update and stock take of the work that had been carried out on corporation tax, personal service companies and self-employed people's taxation.

The OTS hopes that the report will be a useful contribution to current thinking. It does, however, note the Chancellor's statement which followed the announcement he made on the 26 March 2020 about the Covid-19 support package for self-employed people:

"It is now much harder to justify the inconsistent contributions between people of different employment statuses. If we all want to benefit equally from state support, we must all pay in equally in future."

As most people will know, those who work through a personal service company were excluded from any of the Covid-19 financial assistance schemes. This is due partly to the apparent lack of information available to HMRC through the present tax administration arrangements about the amount and nature of company dividends.

Among the various observations and developments highlighted in the report, the following stood out:

- *Simpler tax for smaller companies* – HMRC is continuing to consider the recommendation to explore following the accounts more closely with only a minimum number of tax adjustments being required.

- *Personal service companies* - The OTS suggests renewed consideration of enabling a small personal service style business to operate through a UK limited company while being treated as transparent for tax.

- *Tax administration* – the OTS is interested in an end-to-end tax reporting and payment service to facilitate the simplification of tax administration for self-employed people.

- *Employment and self-employment* - The OTS is interested in the possibility of a statutory definition of employment for tax purposes being developed.

In this article, I will be covering Chapter 2 of that report on personal service companies, employment and self-employment.

Personal service companies, employment and self-employment
In this section of the report, the OTS takes stock of a range of their work relating to small companies. This includes personal service companies, those who provide their services to engagers through them, tax reporting and payment arrangements for self-employed people, the boundary between employment and self-employment and related differences in the incidence of income tax and National Insurance Contributions.

Personal service companies
Working through personal service companies (PSCs) makes it possible to share, or defer, the distribution of income received by the company as dividends, so that it is taxed at a lower rate. If the owner is in a position to significantly defer the distribution of income, then it may be realised in capital form when the company is sold or wound up.

The OTS noted that PSCs were also commonplace because agencies and other engagers will only engage those who have incorporated. This is on the basis that this will help safeguard engagers from employment rights obligations, the costs of Employers' National insurance and the risk of later finding themselves liable for PAYE.[1]

Previous OTS work
The OTS considered a variety of approaches to simplifying the experience of those operating through PSCs, not least in the Small Company Taxation review[2] published in 2016. This is reflected in the discussion in Chapter 1 about a simplified form of corporation tax for smaller companies. Much of the focus of the work was on reducing the greater administrative burdens that come with being incorporated as compared with being a sole trader.

One idea that the OTS explored was for a sole trader to be able to register as a 'Sole-Enterprise with Protected Asset' (SEPA). This would be to gain a limited level of main asset protection but, without otherwise changing their legal or tax status. This was subject to a further review in 2016[3]. I was the lead on this particular piece of work and would still recommend it as an alternative so people could un-incorporate but, still have protected assets.

The OTS also considered the potential for PSCs to be taxed on a 'look through' basis but, the OTS concluded that this would not be simplification overall.

Possible future work
In the OTS's Small Company Taxation Review in 2016, consideration was also given to other possible legal forms which small businesses could take. One of these possibilities would be the potential for legislative changes to enable the formation of single-member limited liability partnerships; or another approach would be the renewed consideration of the S-Corporations in the USA[4].

S-Corporations
The aim would be to provide small personal service type businesses with a fully recognisable form of limited liability, removing them from corporation tax (though accounts would still need to be filed at Companies House), together with the relative ease of a self-employment style tax calculation.

A key question would be whether any of the alternatives would be elective or not. Making it mandatory would involve significant changes in defining the companies to which it applied. The OTS are presuming that the off-payroll rules would still apply, so any alternatives would still have to consider that legislation, which seems counter-productive.

The OTS will continue considering these issues and would welcome contributions from others to this discussion.

---

[1] This was the premise of the IR35 legislation, which provided that engagers did not need to consider status where the contractual service provider was a company.

[2] https://www.gov.uk/government/publications/small-company-taxation-review

[3] https://www.gov.uk/government/publications/ots-final-report-on-sole-enterprise-with-protected-assets-sepa

[4] See https://www.gov.uk/government/publications/small-company-taxation-review

Tax reporting and payment arrangements for self-employed people
As noted in the *Tax reporting and payments arrangements*[5] report in 2019, the OTS consider there is a good deal to be done to improve tax administration for the self-employed. In particular, the report recommended exploration of the potential for HMRC to offer a fully integrated Individual Tax Account, providing an end-to-end tax reporting and payment service.

The OTS did not comment on whether they would be pursuing this any further.

Employment status
It has been well established that there are issues with the categories of employment status for employment rights and for tax purposes. Namely, that there are three categories for employment rights: employed, self-employed and 'worker'; and for tax purposes, there are only two categories: employed and self-employed.

In December 2018, the previous government's 'good work plan'[6] committed to legislating to improve the clarity of the employment status tests. This followed on from the Taylor Review[7] which had recommended that the employment and tax frameworks should be aligned as much as possible and maybe set in statute. The current government has, however, not yet set out a public position on this issue and are yet to respond to the Employment Status consultation[8] published in February 2018.

The OTS is interested in the scope to go further in this area, in particular in relation to the possibility of a statutory definition of employment for tax purposes (and whether it would be practicable or desirable for this also to apply for employment law purposes).

Income tax and NICs alignment
One of the key problem areas is the long-standing structural difference between the treatment of the self-employed and employees for income tax and National Insurance Contributions (NICs). The OTS has considered this is two reports in 2016, the closer alignment of income tax and NICs[9] and the implications of the possibility of employee's NICs operating in the same way as PAYE for the self-employed[10]. Neither report, however, considered the very substantial difference in the treatment of pension contributions for NIC purposes.

So, the key areas for future consideration in relation to people whose work can realistically be done either in a self-employed capacity, through a personal service company or as an employee, are:

- aligning self-employed people's NICs and benefits more closely with those for employees.
- moving to an annual, cumulative and aggregate basis for employee NICs
- bringing taxable benefits in kind into Class 1 NICs
- aligning the definition of earnings and expenses for income tax and NICs

The Chancellor's response to the OTS reports was that progressing this agenda would involve a range of challenges. One significant challenge of bringing employee NIC onto an annual, cumulative

[5] https://www.gov.uk/government/publications/ots-tax-reporting-and-payment-arrangements-review
[6] https://www.gov.uk/government/publications/good-work-plan/good-work-plan
[7] https://www.gov.uk/government/publications/good-work-the-taylor-review-of-modern-working-practices
[8] https://www.gov.uk/government/consultations/employment-status
[9] https://www.gov.uk/government/publications/closer-alignment-of-income-tax-and-national-insurance-contributions; and
[10] https://www.gov.uk/government/publications/ots-publishes-further-report-on-the-closer-alignment-of-it-and-nics

and aggregate basis was estimated to involve 5.5 million people paying more NICs and 7.6 million people paying less NICs.

Subsequent to this, the government attempted to increase the level of Class 4 NICs paid by the self-employed in the March 2017 budget. They then had to do a prompt U-turn after a backlash involving the government's manifesto. It was, however, made clear in a statement to parliament that the government's view was:

"The current differences in benefit entitlement no longer justify the scale of difference in the level of total national insurance contributions paid in respect of employees and the self-employed. Most notably, the introduction of the new state pension in April 2016 is worth an additional £1,800 to a self-employed person for each year of retirement."

That statement in 2017 also re-affirmed the government's commitment to abolishing Class 2 NIC but again, for various reasons, that hasn't happened. It is suggested that the government needs a broader consideration of a suitable approach for resolving these issues including the communication and development of a package of changes that can be implemented in a more coordinated way.

The OTS continues to consider and to discuss these issues with government with a view to moving debate forward.

Conclusion

Despite numerous reports from the OTS on a wide range of issues affecting the self-employed, PSCs, micro and nano-companies, many of which I was personally involved with as a Senior Policy Adviser to the OTS, we do not appear to be much further forward. In addition to the OTS reports, the government also commissioned the Taylor Review and has issued various consultations, most notably the, as yet to be answered, Employment Status consultaiton.

Further to that again BEIS, the Department of Business, Energy and Industrial Strategy has also published various reports on the subject of employment status. This is along with various private individuals and organsiations who have published reports on the debate on tax and employment status. Most recently in July 2020, Prof. Judith Freedman CBE *Tax and employment status: myths that are endangering sensible tax reform*[11] (who is now on the board of the OTS) and the Institute for Fiscal Studies (IFS) *Employment Status, Tax and the Gig Economy—Improving the Fit or Making the Break?*[12]

It should also be mentioned that Uber are currently in the Supreme court in yet another case on employment status, the judgement isn't expected for many months to come but, will it clarfying or mystify this very complex area of tax and employment law. What a conundrum!

Written by: Rebecca Seeley Harris
Date: 24 July 2020

[11] https://www.tandfonline.com/doi/full/10.1080/09615768.2020.1789434
[12] https://www.ifs.org.uk/publications/14957

