

Tax relief for travel expenses: temporary workers and overarching employment contracts – a summary of responses

December 2008



HM TREASURY



HM Revenue
& Customs

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temporary workers and
overarching employment contracts
– a summary of responses

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1

Introduction

1.1 The Government published the consultation document *Tax relief for travel expenses: temporary workers and overarching employment contracts* in July 2008.¹ This document summarises what the Government has learned through the consultation and sets out the Government's policy approach, as informed by the responses received.

1.2 By summarising the responses received, and explaining the Government's approach in light of these, this response document provides an explanation to the policy announcement made at the 2008 Pre-Budget Report:

"5.104 Following the consultation *Tax relief for travel expenses: temporary workers and overarching employment contracts* the Government has decided to leave the current rules unchanged. However, in the light of evidence from the consultation confirming poor levels of compliance in this area, HMRC will refocus its efforts to ensure that the current regime is properly applied. If compliance does not improve, the Government may return to this at a later date."²

¹ <http://www.hm-treasury.gov.uk>

² Pre Budget Report, HM Treasury, November 2008

2

Background

2.1 The temporary workforce is not homogenous; it contains many different types of workers, work patterns, skills, remuneration levels and contractual arrangements. Temporary work can take a number of forms including direct short-term contracts with the end client or providing services through an employment agency.¹ Within these groups workers might be in business on their own account or what might be termed temporary employees.

2.2 Where workers work through an agency, they are usually engaged under a contract for services. However, some employment agencies have started to employ their workers using an overarching contract of employment. This means, that instead of being engaged under a contract for services, the contractual arrangement between the worker and agency is one of employment.

2.3 In recent years the use of intermediary structures has grown in the temporary labour market, used both by those providing services direct to the client or through an employment agency. The most common structure is the limited company where the worker provides his services through the company and is a shareholder and director of the company. In many cases the worker is genuinely in business on his own account and running the company. However, in Managed Service Companies (MSCs), company structures were being used to avoid employed levels of tax and national insurance contributions (NICs). Workers were almost invariably not in business on their own account and the companies were controlled and run by providers. Since legislation was introduced in April 2007² which deems any income earned by a worker through an MSC to be employment income the number of MSCs has decreased substantially.

2.4 An alternative intermediary structure that has become more popular following the MSC legislation is the umbrella company. The worker has an overarching employment contract with the company but is not a shareholder or director. The worker provides services for end clients through the company.

2.5 The consultation focused on two structures, umbrella companies and agencies using overarching contracts of employment. Both of these, by using overarching employment contracts are able to offer temporary workers tax relief for travel expenses for travel between home and work where this would not usually be available.

2.6 Broadly, tax relief for travel expenses is not allowed for travel between home and a permanent workplace.³ Umbrella companies and some employment agencies use an overarching employment contract to link a series of separate engagements into a single, ongoing employment. This changes a series of permanent workplaces (for which no tax relief is due for home to work travel) into temporary workplaces (for which relief is due).

¹ For the purposes of this document “agency” or “employment agency” is used to refer to an agency which supplies workers to end clients and remains part of the ongoing relationship between 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.

² Chapter 9, Part 2, Income Tax (Earnings and Pensions) Act 2003.

³ Very broadly, a permanent workplace is one which the employee goes to for more than 24 months (in the course of a continuous employment) or which the employee goes to for all or almost all of the time for which they are in that employment.

2.7 The Government expressed its concern over the disparity of this situation at Budget 2008, announcing:

“4.70 The Government is concerned at the growing use of structures such as “umbrella companies” or overarching contracts of employment with employment businesses, to obtain tax relief for travel expenses that would not be available to other workers. It will monitor the use of these structures and, if necessary, consider action in the future.”⁴

⁴ Budget, HM Treasury, March 2008

3

The consultation

3.1 Following the announcement made at Budget 2008 the Government launched a consultation on the use of overarching employment contracts by umbrella companies and some employment agencies. The consultation aimed to strengthen the Government's analysis of the sector and the problems that had been identified in order to consider whether action was needed. It also invited comments on possible action to address these problems.

3.2 The consultation document "*Tax relief for travel expenses: temporary workers and overarching employment contracts*", which was published in July 2008, set out the Government's analysis of the sector and highlighted two main problems:

- compliance – there is evidence that some umbrella companies and employment agencies abuse the travel expenses rules in relation to dispensations¹ by encouraging their workers to claim expenses that are not genuinely incurred; and
- fairness – workers operating through these structures are able to claim tax-relief for travel expenses when other temporary workers, working in similar circumstances cannot.

3.3 The consultation was held over the summer and closed on 13 October 2008. A wide range of organisations and individuals responded to the consultation. These included professional bodies, legal and accountancy firms, representative bodies, umbrella companies, employment agencies and individual contractors. In total 57 written responses were received (some written jointly), and 18 meetings were held (of which 13 respondents also submitted written responses). The Government thanks all those who participated in the consultation.

1 Dispensations are issued in order to reduce administrative burdens on businesses. An umbrella company (like other employers) can obtain a dispensation from HMRC that includes agreement to pay flat rate subsistence allowances. Such dispensations allow the employer (the employment business or umbrella company) to pay expenses without having to submit a P11D form, or for the worker to notify those expenses on a Self Assessment return. These payments are effectively treated as tax and NICs-free pay by the employer and worker.

4

Responses to consultation questions

The use of umbrella companies

Box 4.A: Consultation questions

- What influences workers to use umbrella companies? How significant are these factors in relation to each other? Why do workers choose umbrella companies over alternative options?
- What is your view of the Government's assessment of the number of umbrella companies and workers using them? If your assessment is different, on what basis have you reached your conclusions?

4.2 Many of those who responded to the consultation agreed that a principal driver for the use of umbrella companies was the income tax and national insurance contributions (NICs) advantages they offer. However, they disagreed with the idea that this was the sole reason for their existence. It was noted that umbrella companies have existed since before the changes to the employment income travel expense rules were introduced in 1998¹ to give tax relief for travel expenses to site based workers, which effectively enabled umbrella companies to offer this relief to their workers. They argued that the first umbrella companies to be established would not have been able to do so.

4.3 A number of respondents confirmed that umbrella companies provide employment rights, and a few stated that not all workers operating through umbrella companies claim tax relief for travel expenses – they choose to work through an umbrella company because of the employment rights they offer and the security this confers.

4.4 Many respondents also confirmed that umbrella companies provide genuine non-tax benefits. For some workers, who are in business on their own account, they offer the individual an alternative to running their own company. They not only provide income tax and NICs advantages but also employment rights for low administration charges and without the trouble of running a limited company. They also are seen as a “safe” option, providing a low-risk solution to workers anxious about being caught by the Managed Service Company (MSC) and Intermediaries legislation. Furthermore, workers are encouraged to use umbrella companies because they are recommended to them by agencies for reasons mentioned above.

4.5 In terms of statistical analysis, the figures for the number of umbrella companies were broadly seen as correct, although many of those respondents which commented on the issue thought that the amount stated in the consultation document that each worker claimed as travel and subsistence expenses was too high, and that the estimated loss to the Exchequer was also too high. There were conflicting views on the number of workers operating through

1 The employment income travel expense rules (now at section 337 Income Tax (Earnings and Pensions) Act 2003) were amended in April 1998 to allow tax relief for travel expense for site based workers.

umbrella companies. Some agreed with the estimate of 100,000, used in the consultation document while others believed that this figure was overstated since only a few of the largest umbrella companies have workers numbering in the thousands. Others believed that the actual figure was higher than 100,000. However, most who expressed a view acknowledged that they did not have access to comprehensive data and were estimating numbers based on their own experience.

Employment agencies and overarching employment contracts

Box 4.B: Consultation questions

- What influences employment agencies to use overarching employment contracts?
- How prevalent is the use of overarching employment contracts in the agency sector (number of agencies and number of workers)? How prevalent is the use of these contracts by smaller employment agencies? On what basis have you reached your conclusions?
- Has the use of overarching employment contracts increased recently and do you expect it to grow?

4.6 A significant number of respondents said that agencies use overarching employment contracts for many reasons. Principally they are used for marketing purposes (to attract workers to the agency by promising employment rights) and to reassure end clients who do not want to risk becoming involved in an employment relationship with the worker. Several respondents also mentioned that, by employing their workers, agencies are moving in line with a perceived general public policy to give greater rights to temporary workers, exemplified in the Temporary (Agency) Workers Directive.

4.7 These respondents also commented that those agencies which offer employment contracts do not necessarily offer them to all their workers. Some agencies offer them only to certain types of worker where their activity means they are likely to be entitled to tax relief for travel expenses. Part of the rules for tax relief for travel expenses state that if a worker works at the same location for more than 24 months at a time, they are not entitled to tax relief. So for example, an agency may only offer overarching employment contracts to workers who are likely to work at locations for less than 24 months. In this way, the agency only has to commit to providing employment rights when they also receive the benefits from the tax relief for travel expenses (agencies pay less employer's NICs on their workers' pay).

4.8 Another instance where an agency may not offer an employment contract is when a worker's net wage is too low to be able to offer tax relief for travel expenses as part of a salary sacrifice arrangement. Tax relief for travel expenses is generally given as part of a salary sacrifice arrangement meaning that the worker "sacrifices" a proportion of their salary which is instead paid as travel expenses free of income tax and NICs. If a worker's net wage would be driven below the National Minimum Wage were salary sacrifice arrangements put in place, that worker would not be paid tax free travel expenses.

4.9 In terms of the use of overarching employment contracts across the sector, mixed opinions were given. A few respondents said that generally smaller agencies do not operate overarching employment contracts due to the administrative costs of taking on the worker as an employee. However, another respondent claimed that there were some smaller agencies beginning to adopt these contracts.

Potential problems with overarching employment contracts

Box 4.C: Consultation questions

- What is the extent of the problems outlined?
- Are there any further problems?
- What is the extent of non-compliance with the travel expenses rules?
- What factors are contributing to the abuse of the travel expenses rules?
- What practical measures could be taken to address this?

Compliance

4.10 The overwhelming majority of those who responded to the consultation stated that there are widespread compliance problems in the sector. Some contractors said that they had personal knowledge that non-compliance was common in certain umbrella companies, and gave specific examples.

4.11 Umbrella company representatives, in particular, stated that they want to tackle non-compliance in the sector. Umbrella companies that do not abide by the rules and give tax relief for travel expenses which were not genuinely incurred gain a competitive advantage over those that ensure they are compliant. However, both the representatives of umbrella companies and other respondents warned against taking strong action against the non-compliant which would damage the rest of the sector. The majority do not believe that legislation is necessary in order to be able to improve compliance.

4.12 In fact, the overwhelming majority of those who responded said that a lack of consistency in dispensations and scale rates granted by HM Revenue and Customs (HMRC) contributed to non-compliance. This could be addressed by standardisation, for example, scale rates could be set at a specific level and not tailored for each individual company. An industry-led code of conduct was also suggested by a wide number as a practical measure to address non-compliance.

4.13 A number of respondents also commented that the rules of tax relief are unclear and poorly understood and there is a need for better guidance.

4.14 Non-compliance was seen to be more widespread within umbrella companies than the agency sector, where it was not viewed as a particular problem. One reason that was offered as an explanation for this difference, is that agencies may pay lower scale rate allowances, and therefore the amount of expenses claimed illegitimately is lower than when paid through umbrella companies.

Fairness in the tax system

4.15 Few respondents expressed concern over the divergence in tax treatment between a temporary worker working through an umbrella company, and one who is not, as described in paragraphs 6.7 and 6.8 of the consultation document. When commenting on fairness, the majority instead compared the tax treatment of temporary workers (engaged under agency contracts) and permanent employees. They stated that temporary workers should normally be entitled to tax relief for travel expenses because they work in different circumstances to permanent employees. Some went on further to mention that temporary workers do not have

the same job security and are not able to mitigate the cost of travel to the same extent, for example, by moving closer to work.

Casualisation of the workforce

4.16 The comments in paragraph 6.11 on “casualisation of the workforce” were rejected by two respondents. One in particular stated that there is no evidence that temporary workers are being used to replace permanent employees, and that the number of temporary workers in the economy has remained relatively stable for the past ten years. On the other hand, one respondent supports this paragraph, stating that overarching employment contracts allow agencies to reduce the costs of temporary workers to end clients, thus encouraging them to use them more frequently.

Exploitation

4.17 There were mixed responses to paragraph 6.12 on exploitation. A number of respondents said that some workers had little choice other than to work through an umbrella company when they signed up to an agency. For example, some agencies refused to engage workers directly, or, if a worker using an agency did not sign up with an umbrella company, they would not be offered work. However, a few respondents stated that they had no knowledge of situations such as these occurring.

Action to address the problems identified

Box 4.D: Consultation questions

- How well would each option address the problems highlighted [in chapter 6]?
- What effect would each option have on:
 - the temporary labour market?
 - end clients?
 - employment agencies?
 - umbrella companies?
 - workers?
- Are there any alternative courses of action the Government could take?

4.18 The consultation document outlined two main options. It also left open the possibility of making no change to the current legislation if the evidence from the consultation demonstrated that the potential problems outlined in the consultation document were not significant, or that there were negative consequences for business and the sector which outweighed the benefits of taking action.

Allow the existing arrangements to continue but introduce legislation to tackle non-compliance

4.19 The first option highlighted in the document was to allow the existing arrangements to continue but introduce legislation to tackle non-compliance. One possible approach described is introducing legislation including a transfer of debt provision. This could mean that where an umbrella company or employment agency was found to be non-compliant in relation to the

travel expenses rules and failed to pay the income tax and NICs due, HMRC would be able to transfer the debt to specified third parties.

4.20 The overwhelming majority of respondents said that new legislation was not needed. They thought HMRC has the tools it needs and could improve compliance within the current legislation, for example, by standardising scale rates. However, in the event that Government decided legislation was required, this was the preferred option of the two outlined in the consultation document.

4.21 A number thought transfer of debt to directors of umbrella companies and employment agencies would be a proportionate response that would not create undue difficulties for business, but only if this was carefully defined, and in limited circumstances, such as wilful neglect or fraudulent evasion.

4.22 Those who mentioned phoenixism² did not seem to think it was a serious problem, although some said that if it were, debt transfer legislation might be appropriate.

4.23 A few respondents were concerned that debt transfer legislation would encourage agencies to seek to be ignorant of the intermediary structures their workers operate through. This is because agencies have been advised to act in this way in relation to the debt transfer provisions introduced by the Managed Service Company (MSC) legislation. They believe they cannot be caught by debt transfer legislation if they are ignorant of the intermediary structure a worker is operating through. This may have the effect of pushing workers into more non-compliant structures, since currently agencies act in an advisory capacity to workers seeking to operate through an intermediary, and they warn them against non-compliant structures. If transfer of debt legislation were introduced this advice would stop, workers would be left to search for intermediaries themselves, and they could be vulnerable to the marketing of non-compliant and offshore structures without understanding the risks involved in operating through these structures.

4.24 Additionally, the same respondents stated that transfer of debt legislation may lead to the closure of compliant umbrella companies. This is because of the risk of transfer of debt to the directors or shareholders of the company; many compliant directors will not be willing to take this risk, and the only operators left in the market will be those which are less risk-averse (and in some cases more non-compliant).

4.25 A small number of respondents were concerned that the debt transfer provisions from the MSC legislation are still untested, and thought that the Government should wait until the debt transfer provisions in the MSC legislation have been applied in the courts before legislating to introduce transfer of debt provisions in this area.

Removal of tax relief for travel expenses

4.26 The vast majority of respondents were against removal of tax relief for travel expenses. The principal reason for this was because removal of entitlement to this tax relief for temporary workers operating under overarching employment contracts would be likely to cause a migration of workers from umbrella companies to non-compliant structures, or other structures which allow the worker to pay less income tax and NICs, leading to further loss to the Exchequer.

4.27 If entitlement to tax relief were removed, umbrella companies would most likely cease to operate as their business model relies on being able to offer this relief to their employees. Workers would therefore be likely to migrate from these structures. All respondents who commented on the likely behavioural change believe that it is unlikely that a significant number

² Phoenixism may occur when an umbrella company is required by HMRC to pay an outstanding income tax and NICs bill. Since they have few assets, they are able to avoid doing so by winding up and moving their workers to a new company.

of workers would return to the agency payroll or direct employment, as they would suffer lower take home pay as a result. Therefore, it is likely that they would move to other structures,³ which may be non-compliant, that will give them a greater tax and NICs advantage.

4.28 It was also noted that some workers who are in business on their own account choose to work through an umbrella company because it provides a low-risk structure and requires little administration (see paragraph 4.4). If umbrella companies were removed from the market these workers may choose to legitimately work through their own Personal Service Company (PSC). In this way they could choose to structure the payment they receive from the company as a mixture of dividends and salary so that they pay less income tax and NICs as a result, and the Exchequer would lose revenue from such a reaction. A small number of respondents also commented that if the number of PSCs increased, HMRC would face increased burdens since they would have to police these companies under the Intermediaries legislation (IR35).

4.29 A significant number of respondents warned that agencies operate on very small margins. Any costs incurred by removal of tax relief for travel expenses for workers employed by agencies would need to be passed on. This would either take the form of increased costs to the end client, or a reduced rate of take home pay to the worker. Either result would have a negative impact on the temporary labour market at a time when the economy has been affected by major economic shocks.

4.30 Some respondents also thought that it would be very difficult to distinguish between umbrella companies and agencies, and other businesses seconding staff, such as an accountancy firm, in legislation. There was concern that innocent parties would be captured, and a consistent message that any legislation introduced would need to be clear, and well targeted.

4.31 The possibility of damaging the flexibility of the temporary labour market was also raised by a few respondents. The view expressed was that temporary workers may no longer be able to travel long distances to undertake work if they cannot offset the costs of this with tax relief.

4.32 A minority of respondents welcomed the proposal to remove tax relief for travel expenses, stating that this would create a level playing field in the agency sector.

Leaving legislation in its current form

4.33 The overwhelming majority of respondents said that there was no need to legislate to improve compliance – HMRC already has the necessary legislation to tackle this. It was noted that compliance could be improved within existing legislation by increasing consistency in dispensations and scale rates, establishing more effective policing of the current rules, and an industry-led code of conduct (a “review standard”) to encourage industry self-regulation. Clarification of the rules around tax relief for travel expenses was also mentioned as helping to improve compliance in the sector.

4.34 A small number of respondents stated that there is a perception that the Government is “moving the goalposts” in the intermediary sector. For example, respondents commented that after the MSC legislation the Government led them to believe that umbrella companies were an acceptable form of intermediary structure. However, the consultation document considers removing tax relief for travel expenses for workers operating under overarching employment contracts, which would remove umbrella companies from the market.

³ Examples of the types of structures mentioned were self-employed models, Personal Service Companies (PSCs) and offshore intermediaries.

5

Other comments on the consultation

Other issues

5.1 Many respondents compared temporary workers to “site-based” workers (as defined in the 1998 travel expenses legislation) and stated that they should therefore be eligible for tax relief for travel expenses since they were employed under an employment contract and displayed similar characteristics to site-based workers.

5.2 A minority of respondents said that unfair competition resulted from the use of overarching employment contracts. Employment agencies that did not employ their workers were not able to compete with rivals offering their workers tax relief for travel expenses.

5.3 It was noted by a number of respondents that the temporary labour market is going through a period of change, and that this is a difficult time for the sector. A number of respondents mentioned the potential impact of the removal of the Staff Hire Concession on the temporary labour market, stating that this would be likely to increase costs. They added that agencies find it difficult to absorb increased costs since they operate on very small margins, and invariably these must be passed on to the end client or the worker.

5.4 Some representatives of the agency sector felt that umbrella companies and employment agencies should have been distinguished more clearly in the consultation document. They argue that the two are markedly different from one another. Agencies are highly regulated and their principal purpose is to find work for workers rather than an administration service.

5.5 There were also concerns raised by a small number that legislative action in this area would lead to increased costs for temporary labour and greater burdens for business.

6

The Government's approach informed by the consultation

6.1 The Government consulted in order to expand its analysis of the sector in terms of the labour market in which it operates, the size of the sector, the role of these structures in the wider labour market and the problems identified. The Government also sought comments on the possible actions to address these problems including the effect they may have. The option of leaving legislation in its current form was clearly highlighted as an option.

6.2 The consultation has confirmed that umbrella companies and agencies offering overarching employment contracts to workers offer benefits to their workers such as a low-risk alternative to running their own company, with no need to undertake the administration this involves. Additionally, in many cases employment rights are genuinely granted to temporary workers working through these structures, and where they are given, they are of benefit to these workers.

6.3 However, as noted, removal of tax relief for travel expenses would be likely to remove umbrella companies from the intermediary market. This may cause a behavioural change resulting in greater unfairness and loss to the Exchequer if workers move from umbrella companies and employment agencies offering overarching employment contracts to more tax efficient structures, as we would expect them to do.

6.4 The Government is particularly concerned by the evidence of widespread non-compliance in the sector, which has been confirmed by responses to the consultation. Responses indicated that a lack of consistency in the way dispensations and scale rates are granted has contributed to this problem, and that compliance can be improved without the need to make further changes to the existing legislation.

6.5 The Government has considered all the consultation responses and believes that on balance the negative effects of changing existing legislation outweigh the benefits. Introducing legislation either to remove tax relief for travel expenses or to introduce arrangements to tackle non-compliance such as debt transfer provisions would have unintended consequences, and is not necessary at the current time. The Government has therefore decided not to introduce legislation. Instead, and in the light of evidence from the consultation confirming poor levels of compliance in this area, HM Revenue and Customs will refocus its efforts to ensure that the current regime is properly applied. If compliance does not improve, the Government may return to this at a later date.



Consultation respondents

Representative bodies:

Association of Technology Staffing Companies (ATSCo)
Electrical Contractors Association (ECA)
Gangmasters Licensing Authority
Institute of Directors (IoD)
Professional Contractors Group (PCG)
Trade Union Congress (TUC)
Recruitment and Employment Confederation (REC)
Confederation of British Industry (CBI)
Service Providers Association (SPA)
Association of Employment Management Companies (AEMC)

Professional Associations

Chartered Institute of Taxation (CIOT)
Institute of Chartered Accountants of England and Wales (ICAEW)
Low Incomes Tax Reform Group
London Society of Chartered Accountants (LSCA)
Institute of Chartered Secretaries and Administrators (ICSA)

Other

8 Accountancy firms
6 Umbrella company providers/ umbrella companies:
11 Employment agencies
22 other businesses or individuals.

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