



VAT & employment bureaux : the staff hire concession

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In general employment bureaux providing temporary staff to businesses charge VAT on the full cost of this supply. In the mid-1990s some bureaux reduced this tax charge as follows: temps would be taken on as self-employed individuals, not as employees, and paid directly by the client. As a consequence, the bureau would act as an *agent*, rather than a *principal* – and only charge VAT on the commission fee for placing staff. This arrangement was particularly attractive for business clients unable to fully recover their VAT costs, because the main part of their business was VAT-exempt – such as banks and health care providers. However, this put those bureaux placing their own staff, and acting as principals, at a serious competitive disadvantage. To rectify this, in April 1997 HM Customs & Excise introduced a temporary extra-statutory concession: the ‘staff hire concession’ (SHC): employment bureaux could elect not to charge VAT on the salary costs of the staff they placed with clients, provided the client paid these staff directly. Initially the department anticipated that this concession would expire at the end of 1998.

In 1999 the Government announced a major reform of the law governing employment bureaux: in particular, employment bureaux would have to act as a *principal* when supplying temporary staff, to clarify the employment rights of all temps. At this time HM Customs & Excise announced it would withdraw the SHC when the new rules took effect.¹ Many businesses using the concession opposed this change – including suppliers of sheltered accommodation, who argued this would lead to a substantial increase in the costs paid by residents for managers and wardens.

An extended consultation exercise resulted in legislation being introduced in December 2003; the new rules for employment bureaux took effect from 6 April 2004.² In January 2004 Customs announced that the SHC would continue for 18 months after the commencement of these new rules after which the continuing need for the concession would be reviewed.³ A

¹ The background to this reform in employment law is discussed in: *Employment agencies*, Library standard note SN/BT/691, 1 April 2008.

² SI 2003/3319. Certain provisions came into force on 6 July 2004. Background information on this issue is provided by the Department for Business, Enterprise & Regulatory Reform on their site at: <http://www.berr.gov.uk/whatwedo/employment/employment-agencies/index.html>

³ HM Customs & Excise Business Brief 02/04, 21 January 2004

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review was launched in June 2006,⁴ and in Budget 2008 the Government announced that the SHC would be withdrawn with effect from 1 April 2009.⁵

This note discusses the background to this issue.

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1 Reforming the law governing employment bureaux

In February 1997 the Conservative Government published a consultation document on *Employment Agency Standards: charging for information provision*. No action was taken before the General Election of May 1997, and the Labour Government announced that it would be conducting a much wider review of the law on employment bureaux. On 25 September 1998 Peter Mandelson, then Secretary of State for Trade and Industry, set out the aims of the review, one of which was to “make clear that under normal circumstances ‘temps’ supplied by employment bureaux have their contractual relationship with the bureau supplying them rather than the host employer.”⁶

In May 1999 the Government published a consultation document,⁷ and following a protracted consultation period, draft regulations were published in 1 February 2001. Initially it was intended that the new rules would come into force in summer 2001.⁸ However the consultation exercise threw up further outstanding issues and a second draft was issued in July 2002. The final form of these rules was published in December 2003.⁹ The main provisions came into force on 6 April 2004, though certain provisions came into force a little later, on 6 July 2004.¹⁰

One aspect of this reform was to require temporary staff hire – subject to certain limited exception – to be conducted on the basis of a contractual relationship between the bureau

⁴ HM Revenue & Customs Business Brief BB 06/06, 12 June 2006. Responses were invited up to 31 August that year.

⁵ HC 388 March 2008 para 4.54

⁶ DTI press release p/98/727, *Peter Mandelson signals new, clear rules for employment agencies and businesses*, 25 September 1998

⁷ Department for Trade & Industry, *Regulation of the Private Recruitment Industry*, May 1999

⁸ DTI press release P/2001/56, 1 February 2001

⁹ SI 2003/3319. The Order was debated by the Second Standing Committee on Delegated Legislation on 15 December 2003.

¹⁰ DTI, *Guidance on the Conduct of Employment Agencies and Employment Business Regulations 2003 URN 04/516*, January 2004 p 1

and the work-seeker, to make the bureau responsible for giving temporary workers paid holidays and ensuring that they receive the national minimum wage.¹¹ During the consultation exercise, employment bureaux, home carers and those being cared for all expressed concerns about the impact this would have on the VAT position of home carers placed by employment bureaux. In the past many home carers have worked as self employed persons, and have not charged VAT on their services, as their annual turnover fell below the annual registration threshold for VAT.¹² If treated as employees of their bureau, carers would have to refer, not to their own turnover but that of their employer – with the result that many would have to charge VAT in the normal way.

To deal with this problem, in February 2000 the Government proposed a new VAT concession for sick, elderly or disabled people when hiring carers in their own homes.¹³ Following further consultation in December 2002 the Government announced an alternative: a more comprehensive relief to accompany the statutory regime of regulation of private welfare agencies. Under the *Value Added Tax (Health and Welfare) Order SI 2003/24* – which came into force on 31 January 2003 – all welfare services provided by state-regulated private welfare agencies are exempt from VAT.¹⁴

2 Introduction of the staff hire concession

Generally all registered businesses pay VAT on their purchases - known as input tax, and charge VAT on their sales - known as output tax, settling up with the tax authorities the difference between the two, so the cost of the tax is borne by the final consumer. Exempt supplies are outside the tax system.¹⁵ Businesses which make exempt supplies do not charge output tax, and cannot reclaim input tax. In effect, a business making exempt supplies – such as financial services or health care – has to absorb the VAT charged to it by its suppliers. This creates a strong incentive for businesses in these sectors to seek ways to cut their VAT bill.

In November 1996 HM Customs & Excise announced that there was evidence that an informal concession on staff hire was being exploited for tax avoidance purposes:

A supply of staff takes place for VAT purposes where a company receives payment for providing the use of an individual who is contractually employed by it or is one of its directors. Normally, the supplying company must account for VAT on the full amount received, and this applies even if it is simply recharging its own employee costs of salary, income tax etc. Since the early days of VAT, Customs have had an informal concession (the "staff concession") allowing businesses seconding staff not to account for VAT on the salary costs of the staff where the client company pays these direct to the staff involved, or meets the employer's obligation to make payments of income tax etc. to third parties.

¹¹ *Regulation of the Private Recruitment Industry*, May 1999 para 6.5.26; *Revision of the regulations covering the private recruitment industry – regulatory impact assessment*, July 2002 para 31-3.

¹² All businesses must register for VAT if their annual turnover of taxable goods and/or services is above a given threshold, which is currently £67,000.

¹³ HM Customs & Excise Business Brief 3/2000, 22 February 2000.

¹⁴ For more details see, *VAT on domestic care supplied by private businesses*, Library standard note SN/BT/1027, 4 March 2005.

¹⁵ Schedule 9 of the *VAT Act (VATA) 1994* lists those supplies which are exempt under a series of categories, which include finance, insurance, education and health & welfare.

Contrary to the original intention behind the concession, a number of services contractors, such as security and cleaning companies providing services to clients who are partly exempt for VAT purposes, are attempting to use the concession to avoid tax. Customs therefore intend to withdraw the concession with effect from 1 April 1997, but will consult business and trade associations on ways of preserving the original intention of not charging VAT where members of staff are seconded from one organisation to another and the latter pays the staff direct.¹⁶ Withdrawal of the staff concession helps to protect revenue of £550 million estimated to be at risk in the services contract sector. The estimated revenue yield from this measure is negligible.¹⁷

By exploiting the staff concession, a bank, say, would be able to reduce its VAT bill by paying security personnel provided by an employment bureau directly, rather than paying the bureau – as if those staff had been seconded to the bank. However, the bureau would be acting as a *principal* – that is, being the employer of those security staff, and providing their services to their client the bank. Generally when a bureau acts as principal, it is making a *single* supply – for which the consideration is the whole of the charge to the client.

Employment bureaux may also act as an *agent* - placing someone with a client, who has a contract with that client for their services. The person placed might be taken on as a permanent employee, or might be providing their services as a self-employed person (the position of many home carers). In this case two *separate* supplies are being made for VAT purposes:

- The bureau's services in arranging and administering the placement, for which the bureau levies a commission, fee or charge (generally standard-rated for VAT).
- The individual's services for the client company, for which – if self employed – he or she charges a separate fee which would not form part of the employment bureau's outputs. The VAT liability of this second supply depends on the nature of the service the individual provides. In addition the individual might not charge VAT in practice if his or her turnover was below the registration threshold.

It may be helpful here to make a point about terminology. Under the *Employment Agencies Act 1973*, the legislation which regulates this sector, employment **agencies** are those bureaux acting as agents in placing staff, and employment **businesses** provide staff as principals. To avoid confusion the term 'employment bureaux' is used here to cover both.

One problem with simply removing the staff concession would be that employment bureaux providing temporary staff on an agent basis would have an obvious competitive advantage over bureaux providing staff as principals. In February 1997 Customs announced it would amend the concession – renamed the 'staff hire concession' (SHC) – with a view to withdrawing it completely by the end of 1998:

Customs and Excise have announced that the concession on the VAT treatment of supplies of staff, which is due to be withdrawn from 1 April 1997, is to be replaced by a more restricted concession. This will allow the present VAT treatment to continue until 31 December 1998 for employment businesses, as defined by the Employment Agencies Act 1973, which hire staff employed by them under a contract of service ...

¹⁶ (To this end Customs issued a consultation document and invited comments by 28 February 1997.)

¹⁷ HM Customs & Excise Budget press notice C&E11, 26 November 1996

Customs acknowledged, in their consultation document seeking views on the detail of the proposed changes, that withdrawal of the concession would create competitive distortions between employment businesses which supply staff as principals and those acting as agents in the placement of staff. As a result of representations made, Customs now accept that withdrawal of the concession from 1 April will cause particular difficulties for those employment businesses which employ staff under a contract of service.

Accordingly, Customs are now prepared to allow the present VAT treatment to continue until 31 December 1998 for employment businesses, as defined by the Employment Agencies Act 1973, which hire staff employed by them under a contract of service. This is on the very clear understanding that there can be no further extension to this period and, in the meantime, any employment businesses affected will reorganise their businesses in order to comply with the normal VAT rules at the end of this period. During this period Customs will also be looking very critically at the use by employment businesses of agency arrangements as a means of reducing the amount of VAT chargeable on supplies of staff. It remains Customs' intention that the present VAT treatment should continue for genuine secondments in line with the original intention behind the current concession. They will decide how best to do this when they have considered responses to the consultation document from businesses and other interested parties. The aim is to introduce all new arrangements by means of a formal extra statutory concession. A further announcement will be made next month before the present concession expires.¹⁸

In March 1997 Customs published a statement of practice, setting out the SHC; a summary is given below (the full text is reproduced in an annex to this note):

Hire Of Staff By Employment Businesses

The arrangements in Section A of the Statement of Practice ... apply where an employment business within the meaning of the Employment Agencies Act 1973 supplies a member of its staff to another business. They require that the business hiring the employee is responsible for paying their remuneration, and/or for discharging the obligations of the business supplying the employee to pay PAYE, NICs, pension contributions and similar third party payments relating to the employee. In these circumstances any such payments which form all or part of the consideration for the supply of the employee, shall be disregarded in determining the value of the supply. These arrangements will operate until 31 December 1998.¹⁹

3 Regulation of employment bureaux and the staff hire concession

As noted above, in September 1998 the Government announced that it would publish proposals to reform the regulation of employment bureaux. At this time Customs stated that until the new arrangements were in place, the SHC would continue:

The Government announced on 25 September 1998 new rules governing the conduct of employment bureaux and the rights of workers using them. The new rules will make clear that under normal circumstances temporary workers supplied by employment

¹⁸ HM Customs & Excise Business Brief 4/97, 25 February 1997. Sections B & C of the statement of practice dealt with the related issues of businesses *other* than employment bureaux seconding staff, and the secondment of disabled staff under a sheltered placement scheme. They are not discussed in this note.

¹⁹ HM Customs & Excise Business Brief 7/97, 25 March 1997

bureaux will have a contractual relationship with the bureau supplying them, and not the client hiring them. This means that temporary workers will be engaged by the bureau under either a contract of service or a contract for services, and will therefore be placed on an employment business basis, rather than an employment agency basis.

In these circumstances, as the employment bureaux will be contracting with their workers and hiring them out to clients, Customs consider that, combined with other obligations created under the Working Time Regulations and other legislation in the employment area, they will be acting as principals for VAT purposes. VAT will therefore be due on the full amount received from the client, including salary and associated costs in relation to the temporary worker.

Until the new arrangements are in place, Customs have decided to allow a temporary extension of the staff hire concession. This allows employment businesses hiring out staff not to charge VAT on the salary costs of the staff concerned, if the client pays the staff direct. The new VAT arrangements will come into effect when the employment changes are in place, and the staff hire concession is withdrawn. Customs plan to make a further announcement probably in Spring 1999 when the timetable of events becomes clearer.²⁰

The Government's consultation paper was published in May 1999, and it included some discussion of the VAT implications of changing the rules regarding temporary staff hire:

2. Although the standard mode of operation of bureaux supplying temporary workers remains that of an employment business, in certain sectors, such as financial services, temporary workers have increasingly been supplied on an employment agency basis (i.e. contracted to the hirer) rather than on an employment business basis (i.e. contracted to the bureau). This has developed mainly as a means of **tax avoidance** but has also resulted in **workers not benefiting from certain employment rights to which they would otherwise become entitled** and in uncertainty among all concerned as to the obligations of bureaux and hirers to the workers concerned. This is because of the failure in many instances of bureaux to ensure that clear contractual terms are settled between the temporary worker and the hirer.

3. Where a temporary worker is supplied on an employment agency basis their wages do not form part of the taxable supply made by the bureau to the hirer with the result that less VAT needs to be paid. Hiring temporary workers on this basis is particularly attractive to employers unable to offset VAT paid as input tax against their own taxable supplies – the sectors where this is the case include financial services, charities, private healthcare and the public, as they cannot reduce the net VAT paid. Some employment bureaux have begun offering the majority of their services on an employment agency footing – even to clients who derive no VAT benefit – as a means of reducing the bureau's responsibilities to the temporary worker being supplied.

4. At present, temporary workers can be supplied on either an employment agency or employment business basis. The consultation document outlines the contractual confusion arising and the disadvantages to workers of being supplied to carry out temporary work on an employment agency footing. Recent legislation such as the National Minimum Wage and Working Time Regulations makes the distinction between the type of supply increasingly critical. Workers may be unclear against whom they should assert any rights they might have and hirers may be unclear that, in engaging temporary workers under such arrangements, they may incur responsibilities as an

²⁰ HM Customs & Excise Business Brief 20/98, 28 September 1998

employer. It appears that many employment bureaux are either exploiting the existing regulatory provisions to the detriment of workers and hirers or do not understand them.

5. The Government wishes to facilitate the use of temporary labour, but not on a basis designed simply as a means of reducing costs at the expense of temporary workers or tax payers. The extent of this practice is not known in any detail though it is known to be common in the financial sector. As an indicator of the potential tax that might be paid, if it is assumed that about 5% of temporary workers supplied by bureaux are supplied on this basis at an average weekly wage of £179 the tax on that would be £45 million.^{21,22}

Following this in June 1999 Customs confirmed its intention to withdraw the SHC:

The proposals [in the Government's consultation paper] make clear that temporary staff supplied by employment bureaux will have their contractual relationship with the bureaux supplying them, and not the client hiring them. Customs can therefore confirm their earlier view that employment bureaux will be acting as principals for VAT purposes, and that VAT will be due on the full amount received from clients, including salary and associated costs in relation to the temporary staff. Subject to DTI's consultation, the regulations are expected to come into force at the beginning of 2000. The intention is that the new VAT arrangements will come into effect at the same time and the staff hire concession will be withdrawn. Customs will make a further announcement when the DTI consultation exercise is finalised.²³

On 1 February 2001, the DTI issued a revised draft of the new regulations governing employment bureaux with the intention that they would come into force by summer 2001.²⁴ However, as noted above, the consultation raised a number of contentious issues and it was not until December 2003 that a completed draft of the new rules was laid before the House. An updated regulatory impact assessment (RIA) of the regulations, published at this time sets out the main changes as follows (*emphasis added*):

- a) ensuring users are clear on the terms, which apply at any point in their relationship with an agency or employment business;
- b) clarifying the steps to be taken by agencies and employment businesses to establish the suitability of those supplied, to check qualifications where these must be held, and to communicate this information;
- c) *ensuring (with certain limited exception) that the supply of temporary staff is conducted on an employment business basis;*
- d) ending certain practices designed to deter hirers from dealing with other suppliers and limiting the circumstances when fees may be charged if a hirer wishes to engage direct a temp formerly hired from an employment business;
- e) allowing some publications to charge work-seekers for job vacancy information subject to certain safeguards;
- f) removing out-dated regulations which either restrict labour market flexibility or where it appears users are able to protect their own interests.²⁵

The RIA also looked at the VAT implications of the new rules for those hiring staff:

²¹ 500,000 x 0.05 x £179 x 1.1 x 52 x 0.175 (the 1.1 allows for employers National Insurance Contributions)

²² DTI, *Regulation of the Private Recruitment Industry*, May 1999 pp 116-117

²³ HM Customs & Excise Business Brief 13/99, 18 June 1999

²⁴ DTI press notice P/2001/56, 1 February 2001

²⁵ DTI, *Revision of the regulations covering the private recruitment industry – regulatory impact assessment*, November 2003 para 6

On the whole, hirers will face lower costs except for one group: those unable to offset VAT payments against their own taxable supplies. Hirers that currently take temporary staff supplied on an agency basis will have to pay more VAT when temps are supplied on an employment business basis, or move to employing workers direct perhaps paying the agency an initial recruitment fee. Most hirers are able to offset VAT payments against their own taxable supplies, so there will be no effect. Those unable to do this include banks, charities and private individuals. Of these, the only significant users of temps are financial institutions. This restores the situation to that pertaining before a High Court judgment in 1995 created an incentive to supply on this basis.²⁶ The proposal does not therefore add to the *intended* cost of existing regulations.

The only addition to compliance costs is the additional VAT payments. Detailed information on the number of hirers taking advantage of this means of VAT avoidance and the level of labour costs is not available. Assuming 2½% of temps are in such arrangements, average temp wages²⁷ and that the hirer is not eligible for the VAT concession, the current savings to hirers in non-payment of VAT could be about £38 million per year.²⁸ The payment of VAT would represent a significant increase in labour costs for hirers, but we do not have an estimate of the proportion that would be unable to offset VAT payments.

Hirers could reduce this by using permanent staff or by recruiting temporary staff direct if that is cheaper than using services supplied by an employment business. As hirers can change their behaviour, the costs to hirers (and extra revenue to the Exchequer) will be considerably less than the amount not paid in VAT at the moment. Therefore where hirers have been using temps as a way of reducing costs (at the expense of the Exchequer) rather than the requirement to have flexibility, it is likely to lead to a loss of business for some operators.

HM Customs & Excise (C&E) announced on 22 February 2000 their intention to introduce a concession covering those in need who buy care in their own home. This means that the VAT burden on those least able to look after themselves would not be increased as a result of these changes. HM C&E have amended the VAT legislation so that supplies by welfare agencies (for example, domiciliary care, nursing and foster agencies) were exempt from VAT with effect from 31 January 2003. These agencies are also regulated by the Care Standards Act 2000 and Regulation of Care (Scotland) Act 2001.²⁹

Following the introduction of the new regulations in December 2003, Customs announced that the SHC would continue for 18 months after the commencement of the new rules, for those bureaux hiring out their own staff:

This Business Brief updates Business Briefs 20/98 and 13/99, which set out Customs and Excise view on the VAT implications arising from changes proposed by the

²⁶ (*C&E Comrs v Reed Personnel Services Ltd QB [1995]* reported in *Simon's Tax Intelligence* 9 March 1995 pp 412-3 and "Law report: VAT liability depends on the facts", *Times*, 13 April 1995. The Reed employment bureau provided temporary nurses to hospitals. Customs contended that the bureau was providing nursing services (an exempt supply), rather than nurses who in turn supplied their services to the hospitals (ie, only providing administrative services as agent) – noting the terms of the contracts agreed between Reed, its temporary staff and the client hospitals. The Court found for Reed, stating that the contractual arrangements between the parties were inconclusive as to the nature of the supply being made, and as a consequence this question had to be judged from the facts of the case as a whole.)

²⁷ £230 per week, according to the LFS (Spring 2001, UK)

²⁸ = 570,000 x 0.025 x £258 x 1.128 x 52 weeks x 17.5% (based on average wages for agency temps in the LFS and allowing 12.8% for employers National Insurance Contributions - 2003/04 rate)

²⁹ *op.cit.* paras 31-33

Department of Trade and Industry (DTI) to the rules governing the conduct of employment businesses and the rights of workers using them. It also covers the VAT position of wardens' and estate managers' services.

The DTI made the Conduct of Employment Agencies and Employment Business Regulations 2003 on 17 December 2003, which come into force later this year. At present many employment bureaux act as agents for VAT purposes or use the staff hire concession. This enables them to charge VAT on their commission; or on an amount, which excludes the salary and associated costs. As a response to the proposed DTI regulations some bureaux may decide to change their business structure in a way that would make them principals for VAT purposes when they place staff. VAT would then have to be accounted for on the full charges made to their clients, including the salary and associated costs.

Customs has undertaken not to disturb VAT arrangements made under the staff hire concession until it is able to review the impact of the DTI Regulations on the VAT treatment of employment agencies and employment businesses and the effect of withdrawing the concession. Until the review is completed all existing and any new employment agencies and employment businesses, including employment agencies that restructure themselves as employment businesses, can make use of the staff hire concession, as it is currently open to them. The Customs review will commence 18 months after the relevant DTI regulation comes into effect on 6 July 2004, and will include consultation with all interested parties.

Any VAT changes that do arise from Customs' review will apply to all contracts from the date any such changes are brought into effect.³⁰

In March 2004 Customs published guidance for other employment bureaux:

Business Brief 02/04 confirmed that the staff hire concession, which applies to employment bureaux that employ their own staff, will continue for 18 months after the relevant DTI regulations ... take effect in July 2004, after which Customs will review the continuing need for the concession.

Customs have now also confirmed there will be no change in existing arrangements for other employment bureaux. When the relevant DTI regulations come into effect, bureaux which act as agents for VAT purposes and hire out self-employed work-seekers who are themselves acting as principals may decide to change their business structure in a way that may mean they are acting as principals for VAT purposes when they place work-seekers; i.e. they will either become employers of the work-seekers, or they will contract directly with the work-seeker and provide services to the hirer in the capacity of principal.

Until Customs have completed their review, employment bureaux can continue to choose whether to act as an agent or as a principal for VAT purposes, even though the new DTI regulations may mean that they are in reality acting as principals. This choice is also available to employment bureaux which had previously acted as principals when they contracted with self-employed staff to provide services to hirers.

VAT will be due only on the commission element of the charge made by employment bureaux that choose to act as agents for VAT purposes. In such cases, work-seekers who are themselves registered for VAT will have to charge VAT to the hirer on the total value of their services. Invoices issued by employment bureaux acting as agents

³⁰ HM Customs & Excise Business Brief 02/04, 21 January 2004

should therefore show the salary element of the charge to the hirer separately from any commission charged.

In summary, until Customs have completed their review, the VAT position of employment bureaux will be as follows:

- The staff hire concession is available only to employment bureaux that hire out their own employees. It allows them to exclude the salary and associated costs from the VAT charge.
- All other employment bureaux that hire out self-employed work-seekers cannot use the staff hire concession. But they can choose whether to act as agents or principals for VAT purposes.
- Employment bureaux that choose to act as agents for VAT purposes account for VAT only on the commission or margin element of their charges to the hirer.
- Employment bureaux that choose to act as principals for VAT purposes account for VAT on the total charges made to the hirer.
- Customs will accept that the VAT invoices issued by the employment bureaux will be acceptable as evidence of the choice made as to the status of the bureaux for VAT purposes.
- Until the Customs review is completed, all new employment bureaux can also take advantage, as appropriate, of any of the above arrangements.³¹

4 Wardens and managers in sheltered accommodation

One sector where the SHC has been used is the supply of sheltered accommodation. The company which supplies the accommodation may decide not to take on the wardens and managers running these sites as employees; rather, residents pay these staff directly, rather than the company, and as a consequence VAT is not charged on this supply. Following the publication of the draft regulations in early 2001 - McCarthy & Stone, one of the country's leading suppliers of sheltered accommodation - encouraged residents to complain about the proposal withdrawal of the SHC, sending a series of letters to local newspapers.³²

During Treasury Questions on 10 May 2001 the then Paymaster General, Dawn Primarolo, when challenged by Graham Brady about "a new stealth tax of VAT on pensioners living in care homes", responded, "on [the hon.Gentleman's] allegation about VAT charges with regard to pensioners, I point out that there are no VAT changes ... there will be no change in the proposals that are currently operational with regard to these services."³³ The issue appears to have been raised just once in the House subsequent to this exchange:

Mr. Swayne: To ask the Chancellor of the Exchequer what representations he has received regarding the levying of VAT on managers' salaries in retirement accommodation where the service provider is not the freeholder; and if he will make a statement.

Mr. Boateng: There have been a number of representations on this issue. However, there has been no change to the VAT treatment of such services. If future changes to employment regulations have the effect of altering the VAT treatment, parallel changes

³¹ HM Customs & Excise Business Brief 10/04, 19 March 2004

³² For example, "Letter from Keith Lovelock, Chief Executive McCarthy & Stone plc", *Bath Chronicle*, 24 April 2001. The issue was also reported by the *Daily Mail*: "No shelter from latest stealth tax", 2 May 2001.

³³ HC Deb 10 May 2001 cc 257-8

will be made to ensure there is no increased VAT charge on managers' services in retirement accommodation.³⁴

As noted above, after the new rules on employment bureaux were introduced in December 2003, Customs confirmed that the SHC would continue to operate until July 2004 at the earliest. The department also gave some guidance on the position of wardens and estate managers:

Employment bureaux that hire out temporary (that is, self-employed) workers as wardens or estate managers can choose to act as agents for VAT purposes and charge VAT on their commission only. Those that hire out their own employees can choose to use the staff hire concession. Others, such as managing agents, which are not employment businesses, cannot use the staff hire concession. However, provided they invoice and collect payment directly from residents of the properties, they can VAT exempt these charges under the terms of the extra-statutory concession for all domestic service charges.³⁵

The reference here is to an extra-statutory concession concerning service charges on domestic accommodation.³⁶ The supply of domestic accommodation is exempt from VAT, although generally services provided to freehold owners of dwellings are taxable because there is no supply of domestic accommodation to link those services to. By concession, *mandatory* service charges paid by occupants of dwellings may be treated as exempt.³⁷

5 Recent developments

The department launched its review of the SHC in June 2006;³⁸ details were given in a press notice:

Currently, many employment bureaux act either as agents for VAT purposes or, are able, as principals, to use the staff hire concession. In either case, bureaux are only required to charge VAT on their commission, or on an amount excluding salary and other associated costs. The purpose of this Business Brief is to announce the start of a review of these VAT arrangements, taking into account the Department of Trade and Industry's (DTI) 2003 Conduct of Employment Agencies and Employment Business Regulations. The review will inform decisions on the future of the current arrangements and will consider issues such as:

- Existing use of the staff hire concession and the effect of any withdrawal;
- The VAT treatment of employment bureaux, dependent on their status; and
- The impact of the DTI Regulations, under which some bureaux may have changed their business structure in a way that makes them principals when they place staff.

... The views of affected businesses and other interested parties on the above issues are invited to help inform the review. Where possible, representations should be

³⁴ HC Deb 8 January 2002 cc 790-1W

³⁵ HM Customs & Excise Business Brief 02/04, 21 January 2004

³⁶ ESC 3.18 in *VAT Notice 48: Extra statutory concessions*, March 2002

³⁷ *Tolley's VAT 2008* 2nd ed. para 42.4(5). Further guidance is provided in HM Revenue & Customs, *VAT Notice 742: Land and property*, March 2002 paras 12.1-2.

³⁸ "Review of tax concession could increase cost of temporary staff", *Financial Times*, 16 June 2006

supported with evidence of existing use and impact. Any contributions must be received by 31 August 2006.³⁹

The Government announced the outcome of this review in Budget 2008: that the SHC would be withdrawn with effect from 1 April 2009:

Following the introduction of the [2003 regulations governing employment bureaux], changes were made which restricted the ability of employment agencies to make payments directly to temporary workers. This means that, where workers are paid directly by an employment bureau, the bureau will be acting as an employment business and a principal for VAT purposes. Now that the regulatory framework for this sector has been amended to ensure equal treatment for those operating on the same commercial basis, HMRC consider that this tax concession is no longer necessary. Furthermore, the concession has no basis in UK or EU VAT law and must therefore be withdrawn. Accordingly, VAT will be applied to all of the consideration employment businesses receive, including the wages element, in respect of the supplies they make.

HMRC recognises that different providers and hirers will be impacted in different ways, depending on the extent to which the additional VAT costs are passed through to hirers, and their ability to recover the VAT. As a result, the concession will not be withdrawn until 1 April 2009, giving over 12 months for providers and hirers to prepare for the change, and adjust their contracts and business plans accordingly. During this transitional period HMRC will be happy to discuss the impact of the change further with those in affected sectors.⁴⁰

An impact assessment gave some details of the numbers of suppliers and customers which would be affected:

Based on the Recruitment and Employment Confederation (REC) census for 2006 there are around 10,500 recruitment businesses around 95% of which would be considered to be micro or small as they employ 50 or less people. Although not all such businesses will currently be applying the concessionary arrangements, it has been assumed, for the purposes of calculating these costs, that they will all require some familiarisation. Customers who currently benefit from the use of the concessionary arrangements fall into the following main categories:

- VAT registered partly exempt businesses
- Voluntary aided schools
- Care and Nursing Homes

It is estimated that there are around 40,000 partly exempt businesses that have their input tax recovery restricted, 4,250 voluntary aided schools and 17,500 care and nursing homes.⁴¹

The department published a summary of the responses it had received, with its comment; on the concerns raised about the impact of the SHC being withdrawn, the department made the following remarks:

The SHC permits bureaux to account for VAT on their profit margin rather than the full value of the supply. This means that they charge VAT on a lower amount, resulting in

³⁹ HM Revenue & Customs Business Brief BB 06/06, 12 June 2006

⁴⁰ HM Revenue & Customs, *Budget 2008 Technical Note - VAT: Withdrawal of the Staff Hire Concession*, March 2008. This is available at: <http://www.hmrc.gov.uk/budget2008/tn-withdrawal-staff-hire.htm>

⁴¹ *Impact Assessment of the withdrawal of the VAT: Staff Hire*, 12 March 2008 p6

their customers incurring less VAT as input tax. This is especially significant where their customers are not able to recover the VAT they are charged such as fully or partly exempt businesses or charities. The financial benefit obtained from the existence of the SHC is obvious given that it means that budgets incur a reduced VAT element for those unable to recover it in full. The comments above make clear that the SHC also has 'trickle-down' benefits to employment bureaux and workers because hirers' budgets stretch further.

The fact that the concession has now existed for 11 years means that, for some of those who have benefited from it, it is the only VAT treatment they have ever known. For customers with limited VAT recovery, exposure to the normal requirement of VAT being charged on the full value of the supply clearly has consequences. HMRC accepts that there could be consequences not just for hirers, but also for employment bureaux and workers.

The estimated revenue yield of £125m a year following the withdrawal of the SHC suggests that the overall impact on the UK's temporary labour market (which had a turnover of £25bn in 2005-06) will be limited. However, the impact within any particular sector is uncertain, and will depend on (a) the ability of providers to pass on the extra VAT to hirers, (b) the ability of hirers to recover any extra VAT they are charged, and (c) the ability of hirers to pass on any extra irrecoverable VAT in the form of higher charges to their customers.⁴²

In this document, the department noted that those traders benefiting from the SHC "pay less tax but this is inconsistent with normal VAT rules and EU commitments." In addition, "although not the main driver ... withdrawal of the SHC will neutralise certain tax avoidance schemes that have emerged over recent years."⁴³ In a short debate in the Lords in November 2008, Lord Davies – speaking for the Government – noted the Government had "wanted a decent lead-in time before the concession was withdrawn" but that the concession had been introduced "to correct a distortion of competition that no longer exists, and there is no basis in law for its retention."⁴⁴

Following the 2008 Budget, the Recruitment and Employment Confederation strongly criticised this move – arguing that the department's impact assessment "fails to assess the financial impact for the client organisations [of employment bureaux], which will now have to find an extra £125m a year."⁴⁵ The worsening economic climate has led to calls for the life of the SHC to be extended.⁴⁶ On 19 January the chief executives of a number of recruitment companies wrote an open letter to the *Financial Times*, reproduced below:

From Mr Kevin Green and others.

Sir, We are writing on behalf of the many clients that rely on us for the effective provision of temporary staff.

For the past 11 years, businesses that are unable to recover value added tax have been eligible for a staff hire concession. From April 1 2009, this concession is due to be withdrawn. This will have huge implications for businesses and for jobs. The

⁴² VAT: Review of the staff hire concession: Summary of Responses Document, 27 March 2008 p9

⁴³ VAT: Review of the staff hire concession: ..., 27 March 2008 p5

⁴⁴ HL Deb 20 November 2008 c1206, 1204

⁴⁵ "Warning over cost of change to staff hire VAT", *Financial Times*, 13 March 2008

⁴⁶ For example, "Call for VAT rethink on City temporary staff", *Financial Times*, 24 September 2008; "Ministers attacked for 'tax on jobs'", *Financial Times*, 19 January 2009; "Employers call on Treasury to postpone 'tax on jobs'", *Financial Times*, 14 March 2009.

additional VAT charged to businesses as a result of this withdrawal in the financial services, healthcare, education and charitable sectors is estimated to be £390m. We question why at this time VAT should be added to temporary workers' salaries rather than just on the fees (ie the charge for our service) as is currently the case. This amounts to an additional tax on jobs at a time when many organisations – particularly in financial services – will be experiencing the deepest recession for nearly 20 years. Many of our clients are telling us that they will cut back on the number of positions they offer because of the additional cost, thereby adding to already increasing levels of unemployment and to the UK's welfare bill.

We are calling on the government to delay the withdrawal of this concession until 2011 at the earliest. By this time, the economy should be recovering and the impact mitigated. This is a real test of the government's commitment to helping workers and businesses at this difficult time.

Kevin Green, Chief Executive, Recruitment Employment Confederation
Alistair Cox, Chief Executive, Hays plc
James Reed, Chairman, Reed Executive
Steve Ingham, Chief Executive, Michael Page International
Catherine King, Chief Executive and UK Ireland, Adecco UK
Mark Cahill, Managing Director, Manpower UK
Desmond Doyle, Group Chief Executive, Impellam Group
Roger Englefield, Managing Director, Pertemps
Brian Wilkinson, Executive Board Member, Randstad UK Holding⁴⁷

Representatives from the banking and charity sector have also written an open letter to the press, arguing that “any expected increase in VAT revenue from the removal of the staff hire concession will be more than offset by a decrease in PAYE income tax and national insurance contributions”; it is reproduced in full below:

Sir, The British economy is in recession and the jobless total is set to soar past two million. Yet the Government is only two months away from ushering in a change to VAT that will add to the tax burden on job creation at a time when we can least afford it. We write as representatives of those sectors affected by this change. We know that our members cannot afford to maintain current levels of staffing if VAT is added to the wages of temporary staff. We suspect that as many as 150,000 temporary jobs in our sectors could be affected by this change. The Charity Tax Group and the Charity Finance Directors' Group have found through surveying their members that the average cost of this change will be £250,000 to each member. This represents a substantial sum to a charity and could not come at a worse time.

In other areas temporary workers for various public sector bodies including NHS trusts, colleges and housing associations, as well as those in the financial services sector are all similarly unable to recover all the additional VAT costs and will be equally exposed. The biggest loser out of all this will, of course, be the Treasury, at a time when it needs more than ever to balance its own books. Any expected increase in VAT revenue from the removal of the staff hire concession will be more than offset by a decrease in PAYE income tax and national insurance contributions. Lord Mandelson has rightly said that he will review the impact of all new regulations. We ask that he urge his colleagues in the Treasury to conduct a similar rethink, if an already deteriorating labour market is not about to become a good deal worse.

⁴⁷ “Letter: Removal of VAT concession will hit number of temporary jobs”, *Financial Times*, 19 January 2009

James Churchill, CEO, Association for Real Change
Martin Doel, CEO, Association of Colleges
Angela Knight, CEO, British Bankers' Association
Katja Hall, Employment Policy Director, CBI
Keith Hickey, CEO, Charity Finance Directors' Group
Mike Parkinson, Chairman, Charity Tax Group
Darren Mellor-Clark, Chairman, London Investment Banking Association VAT
Committee
Kevin Green, Chief Executive, Recruitment and Employment Confederation.⁴⁸

However the Government has not given any indication that it is considering such a course of action; in fact, on 19 March the department published guidance on the implications of the end of the SHC for employment bureaux.⁴⁹

⁴⁸ "Letter: Change in VAT will create more job losses", *Times*, 26 February 2009. see also, CBI press notice, *CBI reaction to Government's removal of VAT concession on temps' wages*, 20 March 2009.

⁴⁹ HM Revenue & Customs, [Withdrawal of the VAT Staff Hire Concession on 1 April 2009 - VAT Information sheet 03/09](#), March 2009

Hire of staff by employment businesses

1. The new arrangements described in paragraph 2 below apply between 1st April 1997 and 31st December 1998 (both dates inclusive).
2. Where an employment business within the meaning of the Employment Agencies Act 1973 supplies a member of its staff (the employee) to another business which –
 - (a) is responsible for paying the employee's remuneration directly to the employee, and/or
 - (b) discharges the obligations of the employment business to pay to any third party PAYE, NICs, pension contributions and similar payments relating to the employee,

then, to the extent that any such payments as are mentioned in paragraphs (a) and (b) above form the consideration or part of the consideration for the supply of the employee to the other business, they shall be disregarded in determining the value of the supply of the employee.

Secondment of staff by businesses other than employment businesses

1. The arrangements described in paragraph 2 below apply from 1st April 1997.
2. The secondment by an employer (other than an employment business within the meaning of the Employment Agencies Act 1973) of a member of its staff (the employee) to another business which –
 - (a) exercises exclusive control over the allocation and performance of the employee's duties during the period of secondment;
 - (b) is responsible for paying the employee's remuneration directly to the employee; and/or
 - (c) discharges the employer's obligations to pay to any third party PAYE, NICs, pension contributions and similar payments relating to the employee,

then, to the extent that any such payments as are mentioned in paragraphs (b) and (c) above form the consideration or part of the consideration for the secondment of the employee to the other business, they shall be disregarded in determining the value of seconding the employee.

3. For the purposes of paragraph 2 above, an employer shall not be treated as seconding an employee to another business, if the placing of the employee with that other business is done with a view to the employer's (or any other person associated with him) deriving any financial gain from –
 - (a) the placing of the employee with the other business, or
 - (b) any other arrangements or understandings (whether or not contractually binding and whether or not for any consideration) between the employer (or any other person associated with him) and the other business (or any person associated with it) with which the employee is placed.

⁵⁰ Subsequently this statement of practice was added to *VAT Notice 700/34: Staff*, May 2005 - as appendices A to C. The withdrawal of the SHC relates to just the first section of his statement of practice. The second and third parts – relating to businesses other than employment businesses, and to the sheltered placement scheme – are unaffected (*VAT: Review of the staff hire concession ...*, 27 March 2008 p22).

Placement of disabled workers under the sheltered placement scheme (or any similar scheme)

1. These arrangements apply from 1st April 1997.

2. Where the sponsor of a disabled worker places the worker with a host company under the Sheltered Placement Scheme (or any similar scheme) and the host company

(a) is responsible for paying the worker's remuneration directly to the worker; and/or

(b) discharges the sponsor's obligations to pay to any third party PAYE, NICs, pension contributions and similar payments relating to the worker,

then, to the extent that any such payments as are mentioned in paragraphs (a) and (b) above form the consideration or part of the consideration for the placing of the worker with the host company, they shall be disregarded in determining the value of placing the worker with the host company.