



HOUSE OF LORDS

Unrevised transcript of evidence taken before

The Select Committee on Personal Service Companies

Inquiry on

CONSEQUENCES OF THE USE OF PERSONAL SERVICE COMPANIES FOR TAX COLLECTION

Evidence Session No. 1

Heard in Public

Questions 1 - 12

MONDAY 25 NOVEMBER 2013

4.10 pm

Witnesses: Rowena Fletcher and Robin Wythes

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Members present

Baroness Noakes (Chairman)
Baroness Bakewell of Hardington Mandeville
Baroness Donaghy
Lord Empey
Lord Hope of Craighead
Lord Levene of Portsoken
Lord Myners
Lord Palmer of Childs Hill
Lord Stewartby

Examination of Witnesses

Rowena Fletcher, Deputy Director with special responsibility for the Employment Status Team, HMRC, and **Robin Wythes**, Team Leader of the Employment Status Team, HMRC

Q1 The Chairman: Welcome to the first witness session of this short inquiry into personal service companies. We are very grateful that you have come along this afternoon. This session is being live streamed on the internet, although I do not think we have cameras. As you will be aware, a transcript is taken and an uncorrected version gets put on to the internet, but obviously there will be an opportunity for corrections to be made to it before a final version is uploaded. Before we move on to our evidence-taking, would you like to say anything at the outset about your role in relation to personal service companies, or shall we go straight into questions?

Rowena Fletcher: I can introduce myself. I am Rowena Fletcher and I am deputy director with overall responsibility for compliance and employment status in personal tax. My colleague, Robin Wythes, is the employment status policy team leader in personal tax.

The Chairman: Excellent, thank you. Let us move into questions, then. We shall start with an easy one: whether or not HMRC has an estimate of the size of the personal service company population in the UK, and if you can tell us what has been happening in trend terms—that is, the number of such companies in recent years.

Rowena Fletcher: HMRC estimates that the current PSC population is around 200,000, the same as our estimate from 2010. When IR35 was introduced in 1999, we then estimated the population of PSCs at around 90,000. I need to add to this that we do not routinely estimate the size of the personal service company population, because that information of itself is not terribly useful for our operational compliance activity. It is a pretty broad-brush estimate of a certain type of company. I should add that there is no statutory definition of a personal service company, so there are a number of variables when we profile those companies. It is our best estimate and it is useful for seeing the trends, but when it comes to compliance activity we at HMRC recognise that there are very good reasons for people to operate through personal service companies, so the existence of a personal service company in itself is not an indicator of risk.

Q2 The Chairman: Why do you think the number has gone up so significantly since the introduction of IR35?

Rowena Fletcher: We think that is largely a reflection of changes in the overall way in which the labour market is structured, and that since 2000 more people have chosen to provide their personal services through a personal service company.

The Chairman: So it is a change in the way in which people in the workforce are working?

Rowena Fletcher: Yes, I think that is right. Overall in the workforce we have seen growth in the use of a range of intermediaries, including personal service companies. As I say, though, we do not regard a personal service company in itself as inherently risky; there are very good reasons why people might choose to work in that way. That is why it is interesting to observe the trend, but there is no direct correlation.

The Chairman: Right. And how many of those companies apply IR35?

Rowena Fletcher: Again, we have not recently analysed the number of companies in that population to which IR35 is likely to apply. The way in which IR35 works is that it applies on

a contract by contract basis, as you know, so if we made an estimate of the number of PSCs in the population to which IR35 might apply in terms of our compliance activity, that would not necessarily help us to target the risk because within that population there will be some companies that do not have any contracts to which IR35 might apply, there will be some that may have one or two contracts to which IR35 might apply and there will be other companies all of whose contracts will be within IR35. What we at HMRC need to do is target our compliance activity towards that latter group.

The Chairman: Right. And that latter group is?

Rowena Fletcher: The group where we think their relationship with the client is effectively an employment relationship, so all their contracts will be within IR35.

The Chairman: So roughly how many do you think that population is?

Rowena Fletcher: Again, I do not have a number for that.

The Chairman: An estimate?

Rowena Fletcher: For operational compliance reasons, we do not routinely estimate how many personal service companies we think IR35 applies to. We have made that estimate in the past in our regulatory impact assessment, when we had to say how many people would potentially be impacted by IR35. At that time, we estimated that of the 90,000 personal service companies around 50,000 would be within IR35. That was one of the figures that we also used to estimate our overall Exchequer risk. We have recently looked at our Exchequer risk again, although we have not used the same methodology so I do not have a more recent estimate of how many PSCs IR35 might apply to. However, it is interesting that our overall Exchequer risk is broadly in line with the original Exchequer risk that we estimated when the legislation was introduced.

The Chairman: So that is the sum of tax that you think is at risk.

Rowena Fletcher: The Exchequer risk is made up of the tax that we would get in from people operating IR35, but the larger portion comes from the deterrent effect. That will be made up of people who, if it were not for IR35, would otherwise operate through a personal service company. The other portion of that is where, because of IR35, people are paying themselves above the level of personal tax allowances, whereas if we did not have IR35 they might adopt a more aggressive remuneration strategy.

The Chairman: Can we quantify the Exchequer risk in any sense?

Rowena Fletcher: When we introduced IR35 the original Exchequer risk was £475 million, and our current estimate, which I think is from 2012, is broadly the same.

The Chairman: Thank you.

Baroness Donaghy: So that is money that would be at risk if IR35 did not exist?

Rowena Fletcher: The Exchequer risk is made up of both the Exchequer yield from people who operate IR35 and—the larger portion—the deterrent effect of IR35.

The Chairman: It might be helpful if we could have a note on the differences between the two and whether there are any limitations on how one interprets them.

Rowena Fletcher: I absolutely can provide that.

Q3 Lord Hope of Craighead: I would like to ask a question or two about the opening of inquiries. I would like to take you back in time to April 2012, which I think was the date when you launched the new framework for the administration of these inquiries. As I understand it, the inquiries were going to be targeted at areas that were at risk. Is that right?

Robin Wythes: In 2012-13, we have opened up 256 inquiries into cases where we believe that IR35 represents a high risk.

Lord Hope of Craighead: These are new inquiries?

Robin Wythes: These are new inquiries. In the current tax year we have opened 112 cases to date, in the first six months of the tax year 2013-14. These are all cases that we consider

to represent a high risk: as Mrs Fletcher explained, the companies where generally we believe that all the contracts in a year would be within IR35.

Lord Hope of Craighead: I would like to be quite clear on what these inquiries are. You say that they were in areas where you anticipated that there was a high risk of loss of revenue. Is that right?

Robin Wythes: Yes.

Lord Hope of Craighead: What about medium-risk and low-risk cases? Were you opening inquiries in their case too, or were they being left out while you concentrated only on high-risk cases?

Robin Wythes: There is a spectrum of risk that we look at. We have a finite compliance resource that we can deploy to IR35. We currently have 40 staff deployed to this area for compliance, and their managers plus support staff. We obviously deploy that finite compliance resource where we think it is most effective: in both Exchequer yield and the greatest deterrent effect. This will consider a spectrum of risk with regard to absolute yield and to other factors such as ensuring that there is coverage across various sectors so that taxpayers do not feel that if they are in any particular sector they are somehow immune from investigation. To answer your question, we would not focus exclusively on cases that would yield the most to the Exchequer, but we are simply unable to look at every case that presents any risk of IR35, from the individual contract which Mrs Fletcher referred to to the multiple contracts where for the entire tax year we believe that the personal service company would be within IR35.

Lord Hope of Craighead: Are there cases in that group that are concentrating on the overclaiming of business expenses, that being one of the areas of loss of revenue, or were they directed to the situation where you suspected that people were really employees and were trying to avoid the tax that would be the consequence of being in employment?

Robin Wythes: When we open up an inquiry into IR35 where IR35 has been identified as the principal risk, that is the initial reason why we do so. Having opened it, we look at all aspects of the company's operation of the Income Tax Acts, part of which would be whether any expenses claimed were legitimate within the application of the Act. We are aware that there is abuse of expenses within employers and service companies more widely. We have no evidence to suggest that this is a particular problem that is prevalent in the personal service company sector, but, as I say, to the extent that when we are looking at an IR35 case we look at all factors, and if an abuse of expenses was identified we would deal with that as we would with anything else.

Lord Hope of Craighead: Thank you very much. Just one final point, if you would be kind enough. Is the intention to continue with a larger number of investigations that are presently being carried out, or is there a resource problem in its case too?

Robin Wythes: Currently we broadly intend to maintain compliance coverage, i.e. around 250 cases per annum, as we did last year and have done for the current year.

Q4 Lord Myners: Chairman, may I go back to your first question to Mrs Fletcher? You gave us estimates of the number of people falling into different cohorts, and I think you cautioned us to accept that they were estimates and you did not encourage us to believe that the numbers were terribly precise. Can we draw any conclusion from the fact that HMRC does not have clearer sight on this matter? Is it because it is not one that you consider of great importance, or is it because collecting the data is simply too difficult?

Rowena Fletcher: I certainly would not accept that it said anything about the importance with which HMRC regards the matter. I was trying to say that in our operational compliance activity, we are focusing our efforts on understanding where the risk lies, so that we target our efforts on the highest risk cases. The estimates of the numbers of personal service

companies and the numbers to which the IR35 applies do not help us to achieve that risk estimate.

Lord Myners: Could you enlighten us a little more? When HMRC looks at areas of risk and focus and puts resource in alignment with that, where does this stand as being of concern to you? Is this simply a nuisance, or is this a significant area to which you are applying a lot of attention and which is causing you considerable concern? Could you give us some sense of where on that spectrum HMRC sits?

Rowena Fletcher: Perhaps my best answer would be to explain where it lies in the historical perspective, because clearly there has been a change over the years in the number of investigations that we have opened. There is always a balance between our allocating resources to what we think are the highest yielding investigations and making sure that we have proper coverage to act as an effective deterrent. Broadly, in respect of IR35, I am very mindful that this is an important area, that there is significant Exchequer risk, and that we have to maintain an effective deterrent effect. Equally, the cases can be quite difficult. It would not be appropriate to have huge coverage. We have to try to isolate where we think the highest risk cases are. Putting people through an IR35 investigation clearly imposes a burden on them, so there is a balance to be struck.

Q5 Lord Palmer of Childs Hill: Could I go beyond IR35 historically, in a sense, and ask you if you could just clear my mind on this? We used to have the difference between Schedule E and Schedule E self-employed and employed. I just wonder why the change has come. Someone would be engaged on a self-employed contract as an individual. In the current situation we seem to have moved to these people using personal service companies. Why has there been a change from Bloggs employing five plumbers who were all self-employed—maybe I have picked the wrong trade—to their now being personal service

companies? Are they going on being both at the same time? Are people still being paid as self-employed people as distinct from partnerships or personal service companies?

Rowena Fletcher: I think that is right. There is a range of arrangements that people use. My colleague Mr Wythes might know.

Robin Wythes: It is true that over the past 10 or 15 years the labour market has moved substantially away from the traditional situation where employers and engagers would take somebody on directly under either employment terms or self-employment terms. Quite often if it was under self-employment terms the contracts would be very short-term to do one discrete job. Over the last 15 to 20 years we have seen the increasing use of a number of intermediary arrangements, by which we mean personal service companies, managed service companies, umbrella companies, through which workers provide their services. Many of these are for bona fide commercial reasons, as with personal service companies, and there are a number of reasons why people now prefer to provide services through a personal service company as opposed to directly. Some of them, such as managed service companies, we have said are avoidance vehicles that have been set up explicitly for the purpose of tax avoidance. Personal service companies and the increase in 2000 from 90,000 to an estimated 200,000 is simply a reflection of the way the UK labour market is evolving, primarily for commercial reasons but, it also has to be said, partly to avoid or mitigate tax.

Lord Palmer of Childs Hill: I pick up the comment by, I think, Lord Hope about expenses that are charged against the income. I can see that in self-employment, personal service companies and partnerships, but is the self-employed market becoming more sophisticated in using directors' remuneration, which you mentioned, from the personal service companies, but taking most of the profit in dividends or payments to spouses or children? Is this, in your view, what has been encouraging the move to personal service companies, or is it just to take advantage of limited liability?

Robin Wythes: I think there are multiple drivers behind people incorporating. Undoubtedly some people are incorporating for tax-motivated reasons on the basis that the current tax structure allows an individual who has incorporated to withdraw income in the form of dividends as opposed to earned income, be that self-employment income or employment income, but as you alluded to, there are other reasons why people incorporate, including wishing to provide themselves with the cover of limited liability. In certain sectors there is more kudos in having limited liability as opposed to being an individual. There is no one driver for why people incorporate. Our role in HMRC is to try to differentiate between those who incorporate for bona fide reasons and those who incorporate for tax-motivated reasons, and then to ensure that where the latter applies we are applying the law as Parliament intended.

The Chairman: Before I ask Lord Empey to ask his question, I reminded members of the Committee to declare their interests before first speaking and completely forgot to do so myself, so for the record I declare the interest that I have shares in a large number of listed companies, some of which may or may not have an involvement in personal service companies.

Q6 Lord Empey: Good afternoon. Could I ask you a question in two parts? First, how long does it take for the average IR35 investigation case to be pursued?

Robin Wythes: In 2012-13, for cases that we opened since April 2012, it took 28 weeks on average from opening to closing a case. That compares in earlier years to 110 weeks and over 140 weeks. In keeping with the commitment that we made following the OTS review of IR35, one of the issues the OTS identified was concern on the part of external stakeholders about the time it was taking for HMRC to conclude an investigation into IR35, particularly where, having opened an investigation, we concluded that in fact there was no liability. The 28 weeks primarily reflect cases where we have so far concluded that by and large there is

nil liability, so it would be slightly disingenuous to say that it reflects the average of cases where there is both a yield and no yield, but I hope it demonstrates that we are very committed to dramatically reducing the intervention time. That is partly by virtue of the fact that we have now centralised our compliance resource in four specialist teams. Previously interventions were done by our generalist teams across the UK. Secondly, if we come to the view that IR35 does not apply, we withdraw as quickly as possible and do not prolong the investigation. Where we believe that IR35 does apply, we do all we can, working with the taxpayer, to progress the case as quickly as possible, although ultimately how quickly and effectively we can progress a case will depend on the amount of co-operation that we receive from both the taxpayer and often the agent acting.

Lord Empey: That leads us naturally to the next question. Perhaps you could give the Committee some sense of how many cases are currently waiting to be heard by tribunals?

Robin Wythes: On our current statistics, we have five cases currently under investigation that we anticipate will proceed to tribunal. I say “anticipate”, because obviously at any given point the taxpayer could concede the point, or new evidence could come to light that makes us reappraise our position.

Lord Empey: So you do not have a backlog of cases that are stacked up waiting for tribunals, but you have five pending files that could conceivably be settled before they get to tribunal?

Robin Wythes: Indeed, yes.

Lord Empey: And that is the extent of the backlog at the moment.

Q7 Lord Levene of Portsoken: As I have not spoken before, I declare my interests as chairman of an insurer and of a defence company. I am also a director of the board of the Channel Tunnel and of a bank in Hong Kong. Clearly, as you said, the extent to which personal service companies are being used has mushroomed in recent years. Can you tell us

whether there are particular sectors where this is being concentrated? Presumably, those where this is most concentrated will have the most investigations going through.

Rowena Fletcher: We know that PSCs operate across all sectors, and our risk-based approach intentionally focuses on the inherent PSC tax risk where the taxing obligation lies, rather than looking solely at the skills sector or the business sector in which the PSC operates. Having said that, we also get data and intelligence. Where that relates to a specific sector, that might flow into more investigations in PSCs operating in that sector at any time. We do not routinely target a particular sector, because the risk is in the way the PSC itself operates. There is nothing in the sector that would necessarily make it particularly risky.

Lord Levene of Portsoken: There is no predominance in one industry rather than another.

Rowena Fletcher: More PSCs may be being used in one industry than in another. That may be partly because the nature of the industry makes it appropriate for people to operate in that way. As I said, if we get particular intelligence that leads us to risk assess more cases, that may lead to more interventions in that sector, but again there is a balance to be struck. We have to make sure that we cover all sectors and not focus specifically on just a few.

Lord Levene of Portsoken: I was a little surprised at the number of cases that you said are going on at the moment. I would have thought that there were rather more than that. Do you have a routine for looking at various sectors, even if you have not had any particular information that they should be targeted?

Rowena Fletcher: Absolutely. We constantly reflect on whether we are properly targeting our inquiries and the extent to which we should be looking at particular areas and particular skill sets. Again, you have to remember that the risk lies in the PSC itself where the taxing obligation lies, and again we need to make sure that we maintain coverage across all sectors.

Lord Levene of Portsoken: What leads you to put more effort into one sector rather than another? Where does that information stem from? Is it just a question of studying what is in the public domain, or do people suggest it to you? How does it work?

Rowena Fletcher: We get information from a wide range of sources. We will see what is in the public domain, of course, but we also get feedback from our compliance staff who look at this, and information from companies themselves on occasions.

Lord Levene of Portsoken: So you are happy at the moment that you are fishing in the right ponds?

Rowena Fletcher: I would not want to sound complacent at all. As I say, we constantly look at this, but I would say yes, broadly.

Lord Levene of Portsoken: So you do not get too many nasty surprises?

Rowena Fletcher: I would not want to put forward a hostage to fortune, if I can put it that way.

Q8 Lord Myners: How well do you think the rules of IR35 are understood by the engager, the agency and the worker? Do you think that understanding has increased significantly over recent years or has remained stable?

Rowena Fletcher: I would say that the understanding has increased. I think that over the years people have got used to IR35. Equally, I think it is true to say that we need to improve awareness and that some non-compliance with IR35 is due to lack of awareness or lack of understanding of the rules. We are working with the IR35 forum on this issue to understand how we can better raise awareness of the guidance. Following the OTS recommendations to improve the way we administer IR35, we set up the IR35 forum, which has played an invaluable role in helping us to bring about a better customer focus. In line with our general HMRC compliance strategy, our aim is to work very hard to make it easy for people to comply with the tax rules so that we are only targeting the wilfully non-compliant with our

compliance interventions. Clearly, raising awareness among people who do not know what IR35 is is a key part of that, and we are working with the forum to help with that.

Lord Myners: How much resource do you commit to this awareness programme, and how do you measure the effectiveness of your spend?

Rowena Fletcher: We have an IR35 helpline, which works alongside the contract review service, and we currently have three people who man that helpline. We have other technical specialists who are working on the guidance and are working with the IR35 forum to improve it. Separately, we have some 40 people in specialist IR35 compliance units who work on the IR35 compliance, and they feed what they see into the wider picture to help us to improve our guidance.

Lord Myners: I am not sure that a helpline measures the effectiveness with which you are communicating awareness of IR35, because by definition people are aware by the time they have made their call.

Rowena Fletcher: That is a fair point. It is quite hard to measure what we do not know, in a sense, is it not?

Lord Myners: Yes, and we are trying to establish what you do not know and whether you should know more.

Rowena Fletcher: Again, I come back to what I said, which is that we have this discussion with the IR35 forum, which is made up of representatives of professional contractors.

Lord Myners: But you do not do surveys among the self-employed that ask, “Are you aware of IR35 and what it means?”?

Rowena Fletcher: No, we have not done that.

Lord Myners: How many phone calls a day do you get on your IR35 helpline?

Rowena Fletcher: We have had 1,200 phone calls in the year to April 2013.

Lord Myners: I will do some quick arithmetic. That is not many calls per day for three people.

Rowena Fletcher: No, but they also provide a contract review service.

Lord Myners: Are these three people employed by HMRC?

Rowena Fletcher: Yes they are.

Lord Myners: They are full time. And do you employ in HMRC through personal service companies?

Rowena Fletcher: I think we have one person who is currently employed through a personal service company. As I said earlier, there is nothing inherently wrong with working through a personal service company, and there are circumstances in which it is absolutely appropriate to engage somebody through a personal service company.

Lord Myners: How many people does HMRC employ?

Rowena Fletcher: Around 60,000.

Lord Myners: Out of 60,000, one is employed through a personal service company, and you tell me that you are indifferent to this. There must surely be more to it than that. You are aware of one person. Can I ask whether this one person is in a senior position?

Rowena Fletcher: I am afraid I do not know the answer to that. I do not know what the position is.

Robin Wythes: The person concerned is an occupational psychologist, and I understand that some of the work undertaken by that individual is then delegated by them to other persons, which tends to indicate that it is perfectly appropriate for them to be engaged in that manner. Could I just correct what Mrs Fletcher said. My understanding is that we engage one person through a personal service company who earns over £58,200. I believe that a further seven individuals, all occupational psychologists earning under that amount, are similarly engaged through personal service companies.

Rowena Fletcher: I am sorry, I did not realise that it was that borderline.

Lord Myners: Is there anything in particular about occupational psychologists that makes this an appropriate mechanism for them?

Robin Wythes: Simply because of the nature of the work and the fact that they are able to delegate the work to others who they control and pay, this is considered to be the sort of discrete area where it would not be appropriate for HMRC to take these individuals directly on to our payroll. Equally, we are satisfied that they are fully compliant with their tax obligations.

Lord Myners: Chairman, may I, for completeness, declare that my personal tax affairs are assisted by Deloitte, and I am a director of a number of public companies and a director of fund management companies that invest in other companies that may or may not, I presume, employ people through personal service companies? I also presumably take services at home et cetera through people who may or may not be employed through a personal service company.

The Chairman: Indeed.

Q9 Lord Palmer of Childs Hill: I suppose I must declare that I am still a local borough councillor, and the borough council concerned has had some history of using personal service companies—not under my control. My question arises from what Mrs Fletcher has said about people being used to IR35 and their awareness about it. In that context, what feedback have you had from the guidance given in the publication of May 2012 about those accessible to be affected by IR35? In other words, do the workers know that this guidance exists? You talked about 1,200 calls during the 12-month period. Do people know that there is this guidance that they ought to be looking at? Are there any plans to review it in the light of the experience that you have gained?

Rowena Fletcher: I reiterate that part of the work we are doing is to make the guidance more accessible, so that when people are deciding to operate through a personal service company it is more obvious and transparent to them what the issues are that they need to cover. Even if they do not know about IR35, when they start looking at the website guidance they can find it very easily. We are doing more work on that.

On the guidance that you talk about, which was published in May 2012, it is fair to say that the feedback has been mixed. Some people say that they find the business entity tests, which were launched at that time with case studies, useful, but we have also had a lot of feedback through the IR35 forum that people are not happy with them and they are being used wrongly as an unemployment status test or being manipulated to contrive a score. The business entity tests—this is the guidance that we are talking about, which was launched then—were only ever intended to provide a guide to the likely risk that there would be within IR35 or the risk of having an IR35 compliance investigation, so they were developed with the IR35 forum as an attempt to give contractors greater certainty in IR35, because we were conscious that one of the criticisms of IR35 was that it caused uncertainty. So they were among a number of new processes that were introduced following the OTS review. When we introduced them, we made it clear on our website that we were piloting these and that we might come back to them and update them. Indeed, we are now looking at them again as part of our review of all the processes that were introduced as a result of the OTS review. That will include us looking at the business entity tests to see if they are fit for purpose or whether they could be improved to be more useful.

Lord Palmer of Childs Hill: The use of the web is proactive on the part of the contractor. I wonder whether on an ongoing basis HMRC has considered that when new companies are registered, whether or not they are personal service companies, Companies House should issue them with the up-to-date guidance, in paper format if nothing else. It

probably will not apply to many of those new limited entities, but you are relying on people going on to the website, seeing this document and saying, “Oh gosh, it applies to me”. I suggest that there may be an awful lot of people who probably do not look at the website and certainly not that page. On an ongoing basis, perhaps new companies ought to have that as part of the package that they get from Companies House. Have you thought about that?

Rowena Fletcher: I understand that point and it is part of the work that we are doing with the IR35 forum—thinking about ways in which we can get that message out to people without, as you say, than having to come on to our website in the first place. We are looking at that kind of suggestion.

Q10 Baroness Bakewell of Hardington Mandeville: How much use is made of the HMRC contract review service? Do you think it is widely known? If more people knew about it, would you be able to cope with the demand?

Rowena Fletcher: The contract review service operates alongside the helpline that we have already talked about. Both of them are advertised and promoted through HMRC’s website. As I have explained, in the year to March 2013 we had over 1,200 inquiries and 80 detailed contract reviews were sought, while a further 65 contract reviews have been sought during the current year. The way the contract review service works is that we will give a written certificate of our opinion that is valid for three years, provided that there is no change in circumstances, and if the contract is within IR35 we notify the customer and take no further action. We are looking again at the contract review service to better understand why it is not used more widely. Part of that may be that people are not aware of the service, but part of it may also be that people are worried about its confidentiality, although I assure the Committee, as I assure everyone, that it is confidential and that the team operating the helpline and the contract review service are quite separate from our compliance team, so information is not shared. We also know that what is called IR35 insurance is offered and a

condition of that will be that people do not seek a contract review, so some people are specifically advised not to use the contract review service.

Baroness Bakewell of Hardington Mandeville: You have mentioned that the service is completely confidential. Do you accept that not everyone accepts that it is?

Rowena Fletcher: Absolutely. We are HMRC. It is very clear in our guidance that it is confidential and we give assurances that it is. Equally, though, I absolutely understand that people will have reservations about that, for that reason.

Baroness Donaghy: I think I know the answer you are probably going to give, but does HMRC have any evidence of abuse of expenses rules by people working to personal service companies?

Robin Wythes: As I explained earlier, from our general compliance activity in the labour market we are certainly aware that there is abuse of expenses rules by traditional employers, employment agencies and a range of intermediaries such as umbrella companies. We have no evidence to suggest that the sorts of abuses that we are seeing generally in the labour market are particularly prevalent in personal service companies. That said, where we undertake an IR35 investigation, or indeed an investigation into a personal service company for other reasons, one of the things that we will look at is any claim for tax allowance for expenses. If we felt that there was an abuse, we would deal with that in the appropriate way. I emphasise, though, that there are currently no data to suggest that this is a particular problem in personal service companies.

Baroness Bakewell of Hardington Mandeville: Does HMRC have any devices for identifying how to address the issue? Would they be special to this area or would you adopt the same approach to any abuse of expenses?

Robin Wythes: The approach that we would adopt to the abuse of expenses would probably be more of a general compliance nature rather than for the particularly specialist

teams. The specialist teams, the 40 staff that we mentioned earlier who are focused on IR35, will be aware of the issues that our compliance staff are seeing more widely in the labour market, so there would be a uniform approach to how we dealt with this. However, my perspective at the moment is that the issue is of greater concern more widely than particularly with personal service companies.

Baroness Donaghy: I appreciate that if you gave examples it might plant ideas in people's minds, but would it not be helpful to give an idea of the possible abuse of expenses that HMRC is well aware of—just to assist?

Robin Wythes: For example, a typical straightforward abuse of travelling and subsistence expenses is that a worker is claimed to have incurred travelling expenses and therefore their taxable pay is reduced accordingly, and our detailed examination of the facts that proves not to be the case. That is a relatively crude but, one could argue, effective way of reducing employees' taxable pay. Depending on the nature of the employer, some may be more sophisticated by purporting to present receipts to claim that the individual has incurred expenses. Others tend to operate on a more ransom basis. Each case would have to be judged on its merits. That is a straightforward case. Other employers operate more sophisticated abuses.

Q11 Lord Stewartby: I did not realise until a few weeks ago how little I knew about this whole area. You do not have to read very far into the documents that we have seen, which are themselves drawn from the material that we are considering, but does HMRC have confidence that the people who are applying these requirements—the individuals and employers—understand these questions? That is a very basic question from me, but I wonder, with 400,000 people doing this and the acknowledged complexities that appear in a lot of places, whether there is some doubt about how far beyond these points are taken. A simple question is: do you have confidence that people are completing them correctly? That

is a prime question and you probably cannot give an envelope answer to it. From listening to this afternoon's discussion, I do not really get a feeling that there is a framework that people can measure things against in their own minds and have regard to when they are dealing with those types of question.

Robin Wythes: Could I clarify something? Are you talking about questions on statutory returns? Are you talking about the employer's return and the individual's self-assessment return?

Lord Stewartby: Could you ask your question again?

Robin Wythes: When you say that people do not understand what they have to return, are you talking about when people have to make a statutory declaration on either their employer's return or their income tax return?

Lord Stewartby: I am partly relating to that, although other areas are more likely to throw up the points that you need. These documents, which were not constructed to baffle us, are full of complicated detail. That is the nature of the subject, but it should not obscure what you feel is being done that needs to be done. Are you content overall with the way in which the whole system works?

Robin Wythes: The challenge for HMRC and indeed taxpayers generally, as Mrs Fletcher has explained, is that "personal service company" is a term that was simply coined back in 2000 when we introduced the legislation to address intermediaries. Many individuals operating through service companies do not recognise that term and believe themselves to be genuinely in business on their own account, which therefore provides a challenge for HMRC. When we are trying to communicate information about individuals' statutory requirements, either as an employer or as an individual, including what they need to declare on either their employer's return or their individual income tax return, quite often the language that we use in the questions is anathema to a lot of people. We refer to "service companies" both on

the employer's return and indeed in the individual tax return, so already some people will look at those questions and not immediately recognise themselves as operating through a "service company" or "personal service company". There will always be a challenge in our attempts to communicate with individuals their statutory obligations both in operating the tax system and in what they are required to return on their statutory returns. There will always be a challenge for us to try to use language and explanations that will chime with the vast majority of taxpayers. The extent to which we have achieved that successfully is a moot point; we have with some people, but clearly with others we have not. As Mrs Fletcher has said, one of the things that we are doing through the IR35 forum—in truth, possibly for the first time—is trying to see matters from the taxpayer's perspective, and we are doing that through members of the forum who represent the accountancy profession, contractors themselves and the recruitment. We are asking them how their members or their accountancy bodies feel we are communicating people's tax obligations and reporting requirements, and we are trying to amend our guidance, and possibly in due course even the wording on our statutory returns, accordingly to try to make things easier for people to understand.

The Chairman: Thank you. We are running very short of time. Lord Levene, you have one final question.

Q12 Lord Levene of Portsoken: Clearly, the introduction of IR35 was to try to ensure that the maximum amount of tax that was due was properly collected and paid over to the Revenue. It was certainly not to make some great and fascinating subject people to study ad infinitum. Has any assessment been made since its introduction of how much additional tax has accrued to the Revenue that would not otherwise have come in?

Rowena Fletcher: We do not hold separate data about the amount of tax that we collect from people who are operating IR35. The reason for that is that, as I have explained, part of

the impact of IR35 is its deterrent effect. We cannot disaggregate the amount of tax from people who are actually operating IR35 from the amount of tax that it encourages people to pay through payments of the salary and operating Pay As You Earn on that salary. We collect our yield from compliance activity where people are found not to be correctly operating IR35, and in the past couple of years the annual yield from that has been just over £1.1 million. As I have explained, we see the main impact of IR35 in its deterrent effect and the impact that that has on yield in that way. As I say, when it was originally introduced, the impact was estimated at £475 million, and our most recent estimate of the Exchequer protection was in that same order.

Lord Levene of Portsoken: So it has delivered the amount of additional tax that it was expected to?

Rowena Fletcher: I cannot directly say yes because, as I say, we estimate that only occasionally. However, we are saying that the current estimate of the Exchequer yield, the Exchequer protection, is broadly the same as when it was introduced.

Lord Levene of Portsoken: And is there an estimate of the amount that it costs the Exchequer to police this?

Rowena Fletcher: No, I am afraid I do not have that information.

The Chairman: We may have to pursue that later. Thank you both very much for coming. You are at the start of our witnesses, and inevitably we may accumulate questions as we take evidence throughout the process, so we might prey on your time later in the process, if we may. Thank you very much for an informative session today.