HMRC proposals on overarching employment contracts

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What are the government's plans?

The government is considering whether it is appropriate for employees engaged under overarching employment contracts (OACs) to qualify for tax relief for home to work travel expenses. It considers that this is costing the exchequer £400m a year for relief that was never intended to apply to employees in such circumstances. For example, agency workers engaged on traditional agency contracts (rather than OACs) and other individuals who engage with different employers on fixed term employment contracts do not qualify for such tax relief.

Irrespective of the government in place following the May 2015 general election, it is likely that new legislation will be enacted with effect from 2016, removing such tax relief for employees engaged on OACs.

Why aren't agency workers entitled to tax relief for their travel and subsistence?

Workers engaged under traditional agency contracts are *not continuously employed* by the agency or the end client. Instead, they are deemed to be employees of the agency on a series of separate employments, when they are performing duties for each of the agency's clients. Correspondingly, each place at which the worker works is treated as a separate 'permanent workplace' for which no tax relief is due. Agency workers are compared with the cadre of employees who work at a single permanent workplace with a single employment and who cannot claim tax relief for their travel expenses when doing so.

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However, this can be contrasted with the employee with a single employment, who is required to travel to different temporary workplaces in the performance of his or her duties. Employees who are site based, area based, home based and those said to have 'travelling appointments' are all examples of employees who travel for all or a large part of their employment and who are entitled to tax relief for their travel and subsistence expenses when doing so.

Employees working at different sites could fit either pattern – one giving rise to tax relief, the other not. So what is the right tax treatment? The answer depends upon who the employee is working for when providing his or her services. In a single employment, where the employer requires an employee to travel to a client, the employee is working for the employer, not the client. But in the case of an agency worker, the worker is never 'working for' the agency; he or she is always working for the client. So, when an agency worker travels to see a client, the government currently considers that this is more like an ordinary commuting journey than a business trip.

What are OACs?

An OAC establishes an employment relationship with the worker throughout the duration of the contract, hence the expression 'overarching contract'. Since 2000, employment businesses and umbrella companies have used OACs to contract with workers as employees, rather than as agency workers.

In doing so, the employer and the employee accept the full employment rights and obligations that go with employment. OAC employees then become entitled to benefits and reliefs provided by tax legislation for employees. When an OAC employee works at a client site, provided it qualifies as a temporary workplace – e.g. subject to the 24-month rule in ITEPA 2003 s 339 and the 40% test in HMRC booklet 490, with which we presume readers are familiar – because his contract is overarching, he will fall into the same cadre of employees as the employee with a single employment required to work at a series of different temporary workplaces for which tax relief is due.

What's the difference between an employment business and an umbrella company (UC)?

In contrast with employment businesses, which source work for their workers (however, they are engaged), a UC does not source any work and does not normally fall within the definition of an employment business under the agency workers regulations. Instead, UC workers (whether or not under an OAC) find their own work either independently or through agencies. The UC holds the contract with and pays the worker. The client pays the UC either directly or via the agency, where an agency is involved in sourcing the work. Some employment businesses have set up their own UCs in-house to retain workers who might otherwise sign up with UCs. They continue to provide work to their in-house UC employees in such cases.

UCs can be attractive to employees because payments to the employees are channelled through the UC as a single employer, no matter how many agencies or end clients the worker wishes to sign up with.

UCs operate numerous different financial operating models. Most typically, though, a UC will deduct employer's NICs, an allowance for holiday pay and its fees from the payments it receives from the client/agency. It will then pay the worker the net amount. The worker will be out of pocket at this stage, unless he or she claims sufficient travel expenses to generate enough tax relief to break-even or end up better off.

There are many mechanics for reimbursing such expenses, but the most common models are:

- a salary sacrifice model: this usually involves the worker's pay being reduced and the expenses being reimbursed in exchange for that reduction; and
- a flexible remuneration model: this will usually involve the payment of wages at say, the national minimum wage (NMW), plus the payment of expenses, plus a bonus. As expenses increase, the bonus reduces, with the aim of getting to broadly the same level of total payments, depending on how precisely they are structured. This is argued not to be a salary sacrifice arrangement because nothing is sacrificed; the amounts paid simply vary each week or month according to a formula.

What are the government's specific proposals?

As noted above, the government is considering removing tax relief for employees supplied through a third party to work at a client's premises. Alternatively, relief would be lost only where the worker is supplied through an OAC. However, it would be difficult to define an OAC in legislation; for example, so as to adequately distinguish OACs from ordinary employment contracts and prevent slight variations from causing them to fall outside the chosen definition.

Changing the legislation by reference to the supply of employees to end clients would also need exclusions to prevent collateral damage; for example, when an employee is sent on secondment to a client. If the client is in close proximity to the employer, the current tax rules prevent tax relief for travel and subsistence where there is no significant change in the journey. However, if the employer is in London and the client is in Birmingham, why should tax relief be denied for travelling to Birmingham?

The government does not propose denying income tax relief altogether for travel expenses reimbursed in connection with a salary sacrifice arrangement. Tax and NIC relief on employer reimbursements made in conjunction with salary sacrifice is removed from April 2016, but employees may still claim income tax relief under self-assessment. By contrast, the OAC discussion document proposes to deny tax relief for travel expenses whether under salary sacrifice or not, i.e. OAC employees will not be able to make claims for relief under self-assessment.

Where does this leave OAC workers?

The discussion document raises a number of difficult issues. First, which is the correct comparison? Is an OAC employee like an agency worker or more akin to a site-based permanent employee? Second, it is ironic that the document underlines the importance of the principle that no tax relief should be available for ordinary commuting, while at the same time the Finance Bill 2015 introduces new measures providing local authority workers with a new tax relief for specified ordinary commuting costs – and MPs have long enjoyed a special relief for travel for their ordinary commuting costs.

Unfortunately, there are two reasons for concluding that the proposed restrictions will go ahead. First, the increasing use of OACs means that the cost of tax relief for travel expenses is rapidly increasing, in a way that was not foreseen or intended. The government believes it needs to address this now. Second, there are numerous examples of UC arrangements that breach various areas of legislation. They are often non-compliant with the national minimum wage legislation, and pay day schemes fail under tax and NIC legislation.

HMRC should be mindful, however, that some promoters are none too squeamish about selling schemes already considered by others to be in breach of existing legislation. They are likely to devise new models which will ostensibly counter any anti-avoidance measures introduced. This suggests that the best solution is for HMRC to properly police non-compliant arrangements, rather than seek to extinguish relief for the whole sector. ■

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