



HM TREASURY

# Review of the tax arrangements of public sector appointees

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Presented to Parliament by  
the Chief Secretary to the Treasury  
by Command of Her Majesty

May 2012

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# Contents

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	Page
Foreword	3
Chapter 1      Introduction	5
Chapter 2      Findings of the review	7
Chapter 3      Current framework	11
Chapter 4      Policy proposals	13
Annex A        Terms of reference	17



# Foreword

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The public sector needs to demonstrate the highest standards of integrity. Therefore, when questions were raised about the tax arrangements of senior public sector appointees, I announced a review.

The findings of this review reveal a lack of transparency around the tax arrangements of key public sector appointees – with over 2400 off payroll engagements identified in central government departments and their arm's length bodies – around 85 per cent of these engaged for longer than six months.

There are circumstances in which it may be appropriate for an employer to engage an individual off payroll – and the fact that an individual is engaged off payroll doesn't mean that they are paying an incorrect amount of tax.

However, when an individual is not on the payroll, it is not clear to the employer whether the individual is paying the right amount of income tax and National Insurance in relation to their role.

This Government is committed to tackling all forms of tax avoidance and has taken a wide range of measures to close down tax loopholes. Where the employer is the Government, it is essential that public sector employers are able to assure themselves that their staff are meeting their tax obligations.

This review proposes a three pronged approach to tackling this, ensuring tax transparency while avoiding the imposition of significant administrative burdens on small businesses or departments:

- the most senior staff to be on the payroll, unless there are exceptional temporary circumstances;
- employers to ensure that they have the right to seek assurance about the tax arrangements of long-term specialists contractors; and
- monitoring after one year, with sanctions applied to departments who have not abided by these recommendations.

As a result of these measures, departments should be able to ensure that the tax arrangements of their senior appointees are no longer open to question. And at a time of fiscal consolidation, senior public sector staff will be seen to pay the right amount of tax.



Chief Secretary to the Treasury:  
Rt Hon Danny Alexander MP





# 1

## Introduction

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**1.1** On 31 January 2012, the Chief Secretary to the Treasury announced a review of the tax arrangements of public sector appointees. The aim of the review was to ascertain the extent of arrangements which could allow public sector appointees to minimise their tax payments – and to make appropriate recommendations. The full terms of reference of the review are set out in Annex A.

**1.2** The scope of the review was all bodies covered by HM Treasury guidance *Managing Public Money* (MPM)<sup>1</sup> the guidance against which departmental spending is audited – see Box 1.A. The review covered engagements as of 31 January 2012 and the scope included the Senior Civil Service (SCS) and their equivalents in the wider public sector.

**1.3** The review was carried out by officials in the Treasury's Public Spending Group, drawing on expertise from across government. The Cabinet Office carried out a data collection exercise covering all government departments and their arm's length bodies. In light of this information, policy proposals were then developed by a cross government Working Group, overseen by a cross-government Steering Group, which brought together directors of finance, tax, procurement and human resources from seven government departments.

### **Box 1.A: *Managing Public Money* and the scope of the review**

The scope of the review was all bodies covered by *Managing Public Money* (MPM). Arrangements set up explicitly to avoid tax are already forbidden under MPM. This states that "public sector organisations should avoid using tax advisers or tax avoidance schemes as any apparent savings can only be made at the expense of other taxpayers or other parts of the public sector".

MPM covers central government bodies, including NHS Trusts and non-maintained schools. Local Government and the Devolved Administrations are not covered by MPM. However, the Secretary of State for Communities and Local Government has written to the Local Government Association to highlight the issue and has published guidance which makes clear that local authorities should actively review their approach to the remuneration of senior appointments, particularly where arrangements exist which could be perceived as seeking to minimise tax payments. The Chief Secretary has written to the Devolved Administrations in similar terms.

The BBC's Royal Charter is clear that the BBC is independent in the management of its affairs. However, the Secretary of State for Culture, Olympics, Media and Sport has written to the Chair of the BBC Trust, drawing attention to the review and noting that the BBC should play its part in ensuring that all employees and contractors pay tax appropriately.

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<sup>1</sup> *Managing Public Money*, HM Treasury, October 2007



# 2

## Findings of the review

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**2.1** The vast majority of individuals engaged by the public sector are on the payroll – and therefore are subject to Pay As You Earn (PAYE), with income tax and employee National Insurance Contributions (NICs) deducted at source by the employer. The focus of the review, therefore, was with the minority of individuals who are engaged to provide services within the public sector – but who do not have PAYE and NICs deducted at source – and are therefore ‘off payroll’.

**2.2** There are many circumstances in which it may be appropriate to engage an individual off payroll – for example, when they are a specialist carrying out a short-term role for which civil service expertise is not available. In addition, an individual engaged off payroll may pay the correct amount of tax. For example, they may be:

- self-employed and paying income tax and NICs via self-assessment;
- supplied by an agency and on the payroll of the agency; or
- working through a personal service company and genuinely in business on their own account, drawing the profits as salary or operating IR35 (see chapter 3).

**2.3** However, when an individual is not on the employer’s payroll, it will not always be clear and transparent to the employer that the individual is meeting their income tax and NICs obligations. Contracts do not currently give departments the right to request detailed tax assurance from individuals, and HMRC cannot provide this information due to taxpayer confidentiality. Therefore, to understand if there is a possibility that individuals are in a position where they may be able to minimise their tax and NICs payments, it is necessary to first ascertain how many individuals are not on the payroll of the engaging organisation.

### Central government and arm’s length bodies

**2.4** The review requested information from central government departments and their arm’s length bodies, in relation to all individuals engaged off payroll as of 31 January 2012, where the cost to the department is in excess of £58,200 per annum (the Senior Civil Service minimum). This information includes individuals paid directly, or through an intermediary – including agencies, employment businesses and personal service companies – but excludes secondees, where individuals are on the payroll of the seconding organisation.

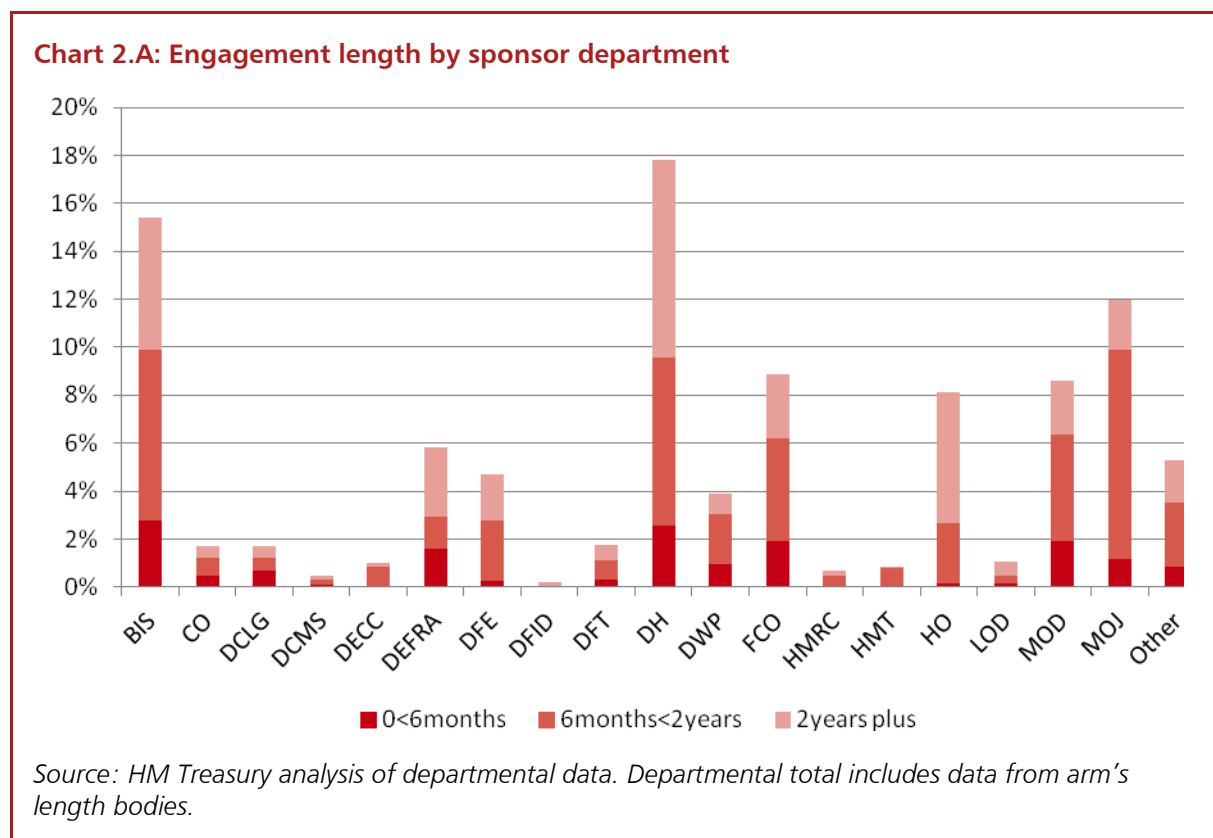
**2.5** Departments have published this data alongside this review, consistent with the provisions of the Data Protection Act 1988. In summary, the review has identified over 2400 engagements that met these criteria. This compares to around 16,000 civil servants who earn more than £58,200 annually. Since 31 January, more than 350 of these contracts have ended, or the individuals moved onto the payroll.

**2.6** Of the engagements identified:

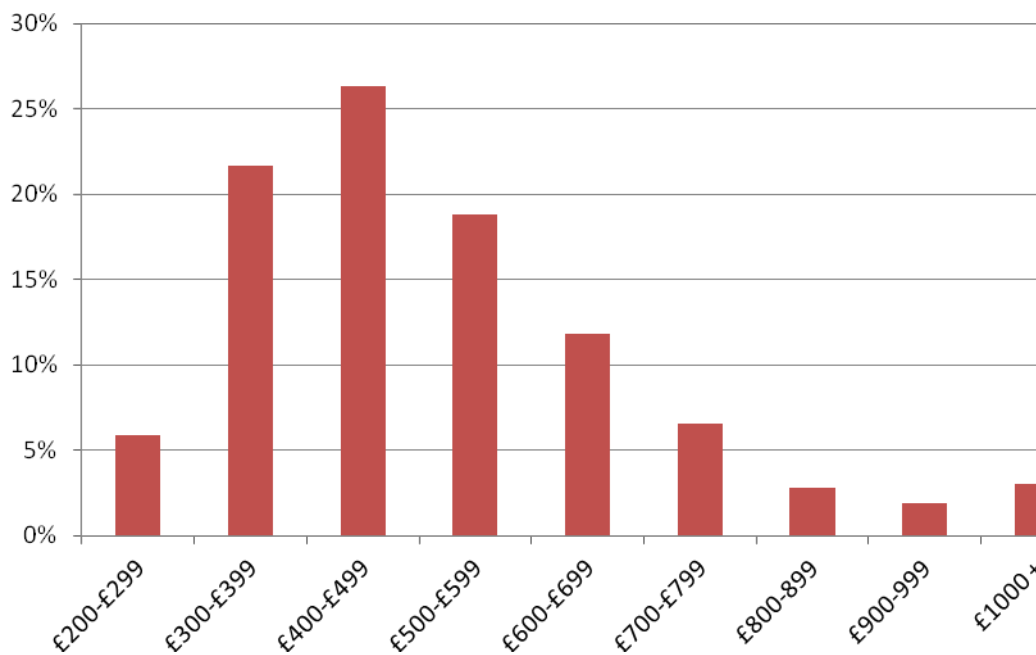
- around five per cent of cases relate to those who might be considered ‘senior management’. The vast majority of cases relate to technical specialists – and over 40 per cent relate specifically to IT specialists;

- around 10 per cent of cases relate to payments made directly to a personal service company – less than five per cent relate to payments made directly to individuals, and over 85 per cent to intermediaries such as employment agencies. In these cases, the individual may be on the payroll of the agency, or may have PAYE operated via another route including via a personal service company;
- around 15 per cent of engagements are currently less than six months in duration, 40 per cent less than 12 months in duration, and 60 per cent less than two years in duration. One per cent of engagements have been in place for more than ten years; and
- the majority of individuals are paid on a daily basis – of these around 70 per cent of engagements involve a daily cost to the department of more than £400 and around 25 per cent involve a daily cost of more than £600. Over 70 individuals were identified as costing departments more than £1000 per day.

2.7 Charts 2.A and 2.B below show the distribution of engagements by duration, daily rate and sponsor department.



**Chart 2.B: Distribution of daily cost to departments**



Source: HM Treasury analysis of departmental data

## The NHS

**2.8** The NHS is covered by *Managing Public Money* guidance and is therefore within the scope of the review. The Department of Health has carried out an exercise to determine the potential scale of senior off payroll engagements in the NHS, surveying the Boards of all NHS Trusts, Foundation Trusts, Primary Care Trusts and Strategic Health Authorities. The results of this survey have also been published by the department, alongside this review. In summary, of around 8,000 people surveyed:

- less than two per cent were engaged off the payroll;
- around 40 per cent of off payroll engagements were for more than a year in duration; and
- the average daily cost of these engagements was around £700.

## Conclusion

**2.9** While an individual being engaged off payroll may be paying the correct tax - the number of off payroll engagements across the public sector, and the length and size of these contracts, suggests that there could be scope for artificial tax minimisation.



# 3

## Current framework

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**3.1** The findings of the review show that there are currently a large number of off payroll engagements across central government, and that there is a lack of transparency over the tax arrangements of these individuals. Before considering potential policy recommendations, however, the review considered the existing framework governing the engagement and tax obligations of these engagements.

### Managing Public Money

**3.2** As set out in Box 1.A, arrangements set up explicitly to avoid tax are already forbidden under Managing Public Money (MPM), the guidance against which departmental spending is audited. The Treasury Officer of Accounts has written to Accounting Officers to remind them of this obligation. When making an off payroll appointment, it is clear that, under MPM, departments should not consider any potential tax or NICs savings to the department from the appointment – as any savings to the department would be matched by a loss to the Exchequer as a whole.

**3.3** Under MPM, departments should also avoid engaging individuals where they suspect that the individual is avoiding tax. However, contracts do not currently give departments the right to request detailed tax assurance from individuals, and HMRC cannot provide this information due to taxpayer confidentiality. Further, it is not always possible for an individual to demonstrate their tax compliance before they begin work (i.e. before the payments have started to be made).

### Tax treatment of personal service companies

**3.4** As set out in Chapter 2, when an individual is engaged off-payroll, there are a number of different ways in which they can pay income tax and NICs. Some individuals are self employed; others may be engaged by an agency but be on the payroll of the agency. Others, however, may be engaged through a personal service company, or through an agency – and then a service company or other company. These arrangements are the focus of the review.

**3.5** A personal service company is often a genuine commercial arrangement allowing an organisation to buy in specialist skills on a short term basis that they would have no use for in the long term. Such companies also allow specialists to offer their services to a number of different organisations and manage these various relationships effectively. Many larger businesses started as small limited companies.

**3.6** There is no requirement for a personal service company to operate PAYE on their income provided that income is not from a contract which would be one of employment if the worker was not engaged through a personal service company. Many people who work through personal service companies will choose to withdraw at least part of their profits as salary and pay the income tax and NICs associated with doing so.

**3.7** However, personal service companies can be used to disguise employment income and provide the opportunity for the worker to avoid tax and NICs. To prevent personal service companies being used as avoidance vehicles, in April 2000 Parliament enacted the anti-avoidance intermediaries legislation, commonly known as 'IR35'. This ensures that income which is truly from employment is taxed as employment income and has tax and NICs deducted. HMRC has strengthened its specialist teams who investigate cases where there is potential non

compliance with employment taxes. These teams also investigate cases where there potentially IR35 legislation should have applied. The data from this review has been provided to HMRC to enrich their risk assessment process. HMRC will open investigations into the highest risks whichever sector the person is working in.

## **Contracting policy**

**3.8** There are a number of reasons why individuals might not be engaged via the payroll. The phrase 'contingent labour' is generally used to describe short-term and/or specialist roles that cannot be filled by existing civil servants. Some off payroll engagements may also relate to consultancy – advice outside the business-as-usual environment – where consultants are engaged on an individual basis. It is the duty of departments to ensure that rules set out by the Civil Service Commission (CSC) for the recruitment of civil servants are not circumvented through the use of contingent labour.

**3.9** Overall spend on contingent labour, including consultancy, in central government departments and agencies was around £2.4 billion in 2009-10 but fell to around £1 billion in 2010-11. When a department decides to hire an individual as a contractor, Cabinet Office guidance recommends that the appointment should be cleared by HR, commercial and finance departments, with final clearance from Accounting Officers or Ministers.

**3.10** The Government has also put in place strict measures with regard to consultancy: in June 2010 it was announced that the Minister for the Cabinet Office would sign off on consultancy requests, which exceeded nine months and where spend was greater than £20,000. This contributed to a 71 per cent consultancy spend reduction between 2009-10 and 2010-11.

**3.11** The Government Procurement Service are currently developing a new contracting strategy for interims, which will replace all current frameworks for central government departments and which will reflect the recommendations of this review. The strategy will introduce a single neutral supplier solution for all departments and their arm's length bodies, providing a single route to the market for interims and specialist contractors ensuring adherence to all compliance and governance controls. This strategy will commence in June, with the procurement of the new framework and suppliers, followed by implementation in departments from the autumn.

**3.12** In addition to the individuals engaged off payroll, there are also a small number of senior civil servants on 'non-standard contracts' with bespoke pay and performance pay arrangements. While these individuals are not within the scope of this review, the Minister for the Cabinet Office is considering the introduction of a new control process to ensure that such arrangements are appropriate and offer best value for money in the Senior Civil Service paybill.

## **Conclusion**

**3.13** Public spending guidance and tax law is already clear that those engaged off payroll should not seek to artificially reduce their tax payments. Actions already taken by Government have meant that spend on contingent labour and contractors has fallen significantly since 2009. However, departments do not currently have the right to assure themselves that those who are off payroll are meeting their tax and NICs obligations.



# 4

## Policy proposals

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**4.1** It will always be necessary for the Government to make a small number of temporary and/or specialist appointments to ensure that public services are delivered effectively. However, it is necessary to introduce a number of measures so that the Government, as the engager of these individuals, has the right to seek assurance that those it engages but does not place in its payroll are paying the correct amount of tax and NICs.

### Deeming Provision

**4.2** At Budget 2012 it was announced that the Government would consult on creating a provision in legislation which would require all organisations in both the public and private sector to place 'controlling persons' on the payroll, even when they are currently working through a personal service company. This will ensure that where someone is able to control and direct the activities of the organisation – for example members of the senior management team – they will be taxed in the same way as other employees of the organisation, with income tax and NICs deducted at source. The Government is today publishing a consultation on this provision, with the expectation that the provision will be legislated in Finance Bill 2013.

### Further measures in the public sector

**4.3** The legislative provision proposed by the Government will help ensure that the tax arrangements in relation to the most senior public sector appointments will be less open to question in the future. However, the provision will not come into effect for a year and will not cover other highly paid specialists identified by the review. The Government will therefore take further steps to ensure that departments have the right to seek assurance that off payroll engagees are meeting their income tax and NICs obligations.

**4.4** In designing these measures, the challenge is to find the right balance between having assurance that where individuals are contracted by central government they are meeting their tax obligations, while avoiding the imposition of significant administrative burdens on small businesses or departments.

**4.5** To find this balance, it is important to consider the different categories of off payroll engagements – and the differing levels of risk associated with each. Based on the information collected by the review in relation to payments of over £58,200 per annum, three broad categories of off payroll engagees have been identified:

- senior management – where the tax arrangements of individuals should not be open to question. Individuals should therefore be on the payroll, unless there are exceptional, temporary circumstances;
- long-term contractors – where the importance of such roles and the size of payment means that departments should have the right to assure themselves that income tax and NICs obligations are being met; and

- short-term contractors – where the potential for assurance needs to be balanced against additional burdens placed on departments and contractors, so it should not be compulsory for departments to place the right to seek assurance in contracts – though departments may choose to do so.

**4.6** In light of this, the review proposes to define the categories and exercise assurance in central government as set out in Table 4.A.

**Table 4.A: Assurance process for off payroll engagees**

Category	Seniority	Length of engagement	Payment	Assurance required
A	Board members and those with significant financial responsibility	Any	Any	To be on payroll. Or, in exceptional temporary circumstances – Accounting Officer to seek assurance on tax/NICs obligations before signing off.
B	Under Board level	Over 6 months	Over £220 per day (approximately equivalent to £58,200 per annum)	The right to assurance to be built into contractual provisions – allowing departments to terminate the contract if assurance is not received when sought.
C	Under Board level	Over 6 months	£220 or under per day	For departments to determine where contractual provisions and assurance may be appropriate.
		6 months or less	Any	

**4.7** The details of the contractual provisions to be included and the assurance process for departments to carry out will be finalised and implemented within three months of the publication of the review. Departments and their arm’s length bodies will carry out these recommendations in relation to all new contracts or contract renewals. Once the right to assurance is placed into contracts, departments will exercise this right in a cost effective manner, according to the risk presented by different cases.

**4.8** To ensure that departments take forward this approach, and exercise assurance in relation to a wide range of cases, implementation will be monitored after one year, reporting to the Chief Secretary to the Treasury and the Minister for the Cabinet Office. Sanctions, in the form of a fine to the departmental resource budget of up to five times the salary in question – will be applied to any department that has not applied the new rules.

**4.9** Departments should also engage with their existing contractors to seek to apply these principles to existing contracts – bringing senior management onto payroll and placing the right to assurance into contracts over six months long and worth more than £220 per day. Any changes to contracts as a result of this process should provide value for money; and departments should inform HMRC of any individuals whose tax arrangements they have been unable to verify for whatever reason. Departments should then report to Parliament on the outcome of this work as part of the 2012-13 annual report and accounts process.

**4.10** The proposals set out above should apply to central government departments and their arm’s length bodies. However, NHS bodies and academy schools also fall within the remit of Managing Public Money guidance and therefore the scope of the review – and it is important that these organisations have the right to assure themselves that their senior off payroll engagees are meeting their tax obligations. It is therefore proposed that the principles set out

above also apply in these organisations, with the Secretaries of State for Health and Education providing guidance on how these principles should be implemented and organisations then accountable to the NHS Board or school governing body.

#### **Box 4.A: Summary of recommendations**

The review recommends that, in central government departments and their arm's length bodies, for all new engagements and contract renewals:

- board members and senior officials with significant financial responsibility should be on the organisation's payroll, unless there are exceptional circumstances – in which case the Accounting Officer should approve the arrangements – and such exceptions should exist for no longer than six months;
- engagements of more than six months in duration, for more than a daily rate of £220, should include contractual provisions that allow the department to seek assurance regarding the income tax and NICS obligations of the engagee – and to terminate the contract if that assurance is not provided;
- these measures should be implemented within three months – and implementation will be monitored after one year, reporting back to the Chief Secretary to the Treasury and the Minister for the Cabinet Office; and
- if it emerges that any departments have not abided by these rules, sanctions will apply – with departmental resource budgets reduced by up to five times the payment in question.

Departments should also seek to apply these principles to existing contracts – subject to ensuring value for money for the taxpayer – and report to Parliament on the outcome as part of the 2012-13 annual report and accounts process.

The Secretaries of State for Health and Education will also consider how to take forward the principles of this approach in the NHS organisations and non-maintained schools that fall under Managing Public Money guidance.



# A

## Terms of reference

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**A.1** To conduct an urgent review of public sector appointments to ascertain the extent to which use is made of arrangements whereby the tax position of appointees is minimised, including where they are paid through a personal service company, and to make appropriate recommendations.

### Objective

**A.2** The Government is committed to tackling all forms of tax avoidance in the public sector. The Government does not believe that tax avoidance is appropriate in the public sector, and the use of tax avoidance devices is already expressly forbidden in “Managing Public Money” – the guidance for public spending against which departments are audited.

**A.3** This review should examine the extent to which senior terms of engagement that could be perceived to minimise tax are currently in place in the public sector, the appropriateness of them, and will make recommendations as to what action should be taken.

**A.4** In reaching its recommendations the review should have regard to:

- the role of appointing bodies, sponsoring Departments, the Cabinet Office and Treasury in reviewing the pay and terms of senior and other appointments in the public sector;
- the need of the public sector to recruit high-calibre individuals or those with specialist skills on temporary and fixed term contracts;
- the integrity of the tax system; and
- the overall value for money of contracts for the Exchequer.

### Coverage

**A.5** The review will cover all bodies covered by HM Treasury guidance on Managing Public Money, including all central government bodies, such as departments and their arms length bodies (which include NHS Trusts). It will not cover arrangements in public corporations, public broadcasting authorities or the publicly owned banks.

**A.6** The review will not cover Local Government, however, the Department of Communities and Local Government will write to the Local Government Association encouraging them to follow the Government’s policy and approach in this matter.

**A.7** It will examine all current appointments, but not those that have ceased, for members of the Senior Civil Service and their equivalents in the wider public sector.

### Timing

**A.8** The review should report to the Chief Secretary to the Treasury by the end of March 2012, in parallel to the investigation underway by Accounting Officers. The results of the review will be provided to the Public Accounts Committee, and placed in the House of Commons Library.





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If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team

HM Treasury

1 Horse Guards Road

London

SW1A 2HQ

Tel: 020 7270 5000

Fax: 020 7270 4861

E-mail: [public.enquiries@hm-treasury.gov.uk](mailto:public.enquiries@hm-treasury.gov.uk)

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