



## POST OFFICE LIMITED, AUDIT RISK AND COMPLIANCE COMMITTEE REPORT

<b>Title:</b>	IR35 - Engagement of contractors – risks and decisions	<b>Meeting Date:</b>	1 July 2024
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### Input Sought: Noting and approval

The ARC is asked to **note** the status of the activity surrounding the historical tax risk and **approve** the revised contractor engagement policy which has been designed to mitigate future tax risk on this matter.

### Previous Governance Oversight

- ARC paper of 21 May 2024 - "IR35 - Engagement of contractors – risks and decisions"
- ARC paper of 12 March 2024 - "IR35 - Engagement of contractors – risks and decisions"
- ARC paper of 23 January 2023 - "Tax Update and Annual Tax Strategy"
- ARC paper of 24 Jan 2022 - "Tax Update"
- ARC paper of 17 May 2022 - "Tax Update – IR35"
- ARC paper of 29 March 2022 - "Future Contractor Profile"
- ARC paper of 24 January 2022 - "Tax Update"
- ARC paper of 30 November 2021 - "Tax Update"
- ARC paper of 12 January 2021 - "Tax Update"
- ARC paper of 28 January 2020 - "Tax Update"

### Executive Summary

In May 2024 a paper regarding the contractor population and the associated IR35 risk was presented to RCC and ARC. This paper addresses the ARC actions following the 21 May meeting.

**Historical treatment** - following a recommendation at the May ARC, the Post Office Tax team have spoken with the Government's Centre of Tax Excellence to check that our approach to assessing status has not been out of line with any policy. This was confirmed in a call that there is no general edict regarding IR35 status and each engagement of a contractor should be assessed individually using HMRC's CEST tool. Discussions with HMRC regarding historical treatment have been on pause as KPMG, our tax advisors, have been unable to assist whilst an ongoing contractual conflict associated with the Inquiry is resolved. As at the time of writing we have begun to re-engage with KPMG and await formal confirmation that KPMG can begin the next phase of this work. The next steps are to discuss the proposed strategy with KPMG before engaging in deeper conversations with HMRC, which we expect to undertake in July.

**Future treatment** – role criticality assessment has been performed for existing contractors, with the support of the SEG. A revised contractor engagement policy has been written and is



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included in Appendix A. The Contractor Review Steering Committee approved the revised policy on 19<sup>th</sup> June 2024. At the time of the Steering Committee the potential financial impact of the policy changes were not known as the financial analysis had not been completed. These have now been completed and additional costs of up to c. £5m per annum are estimated, driven by potential rate increases to convert contractors to inside IR35. Of the £5m, £3.5m relates to government funded programmes and these increases would not be included in the existing funding agreements and cost estimates. This potential increase is deemed a necessary risk to remove the existing financial exposure that is continuing to accrue under the current contractor engagement policy. The policy, along with the financial analysis, is going to SEG on 26<sup>th</sup> June 2024 for management approval.

ARC are requested to approve the revised contractor engagement policy such that it can be brought into effect on 8<sup>th</sup> July 2024.



## Questions addressed:

1. What is the status of the HMRC review and the next steps?
2. What are we doing to mitigate the risks regarding the current and future contractor population?

## Report

### **Current status of the HMRC review**

1. We previously advised that any work with KPMG, our tax advisors, was on hold due to a dispute relating to the Inquiry. We understand a settlement offer has been issued and is due to be finalised, subject to some final points being agreed. We have therefore begun re-engaging with KPMG informally ahead of being able to fully engage once the above matter is resolved, hopefully in the coming week.
2. We have a call to discuss the historic position with HMRC scheduled for 27 June and a further call proposed for 4 July. The intention is to introduce the KPMG team on 27 June to HMRC and to outline our thinking regarding potential ways forward, providing HMRC with time to consider before the 4 July where more in depth discussions can be held.

### **Next steps with HMRC**

3. POL's suggestion is that we break down the historic assessment of contractor status determinations into two data sets, between contractors engaged through Morson and contractors engaged through our previous provider.

### **Period covered by Morson as MSP (January 2023 to present)**

4. It has become clear that as Morson do not accept substitutes due to their own policy we will need to reassess some of the CESTs completed since January 2023 and this could result in a number that have been incorrectly classified as Outside IR35.
5. It has also become apparent that once the Morson policy on substitution was made clear that some CEST questions previously answered in one way have been differently answered when a contract was extended. Any anomalies in answering such CEST questions will be investigated and corrected where required.
6. These corrections to the January 2023 status determinations would like lead to a substantial tax liability.

### **Period from April 2017 to December 2022**

7. It remains our contention that the second data set, covering December 2022 back to April 2017, are covered by our policy that we had no right to reject a substitute. Therefore, the majority of status outcomes were correctly assessed. However, in correspondence, HMRC indicated that it is highly unlikely that a business would accept a substitute in all cases as it may not be practical to do so. We understand this contention and will review the historic contractor population through this lens to assess in what circumstances we



would not realistically have accepted a substitute. This may lead to a liability for this period, which as previously indicated to ARC could be highly material.

8. If HMRC accept these proposals, we will commence the assessment work of the historic data. We will need additional resource to support the review of the large volume of information and may need to call on advisors for this.

### **What are we going to do to mitigate the risk of the current and future contractor population?**

9. At the last ARC, it was advised that a Contractor Review Project had been initiated to mitigate the risks of current and future IR35 related liabilities with Executive sponsorship of the Chief People Officer. The project working group includes a range of subject matter experts from across the business and a full time Project Manager has been assigned to the project.

### ***Progress since the last ARC meeting***

10. To mitigate the risks of current and future IR35 related liabilities, a review of POL's Contractor Engagement Policy has been conducted and approved by SteerCo. This can be found in Appendix A in the reading room. Key amends to the policy include:
  - 5.2. Engagement of an Overseas Contractor – A contractor must reside and work in the UK during the 'assignment' period with the Post Office.
  - 5.4. Expenses – Expenses will not be offered to contractors in addition to the agreed day rate. If a contractor is required to attend other sites on an ad-hoc basis that is not the preferred location as stated in the Vencuro required, incidental expenses can be re-imbursed in accordance with Post Office expense rates. Any incidental expenses are to be approved by the relevant SLP member and/or relevant Head of People Partnering prior to the expense being incurred. Approval can be sought for any immediately incurred expenses within 24 hours of the expense occurring. Incidental expenses are to be processed in accordance with the MSP's expense process.
  - 5.5. CEST – Where there is sufficient ambiguity to be able to provide an outcome (i.e., either Outside or Inside IR35) Post Office's default position is Inside IR35. Should the CEST provide an Outside IR35 outcome, further review and approval is required by the Head of Talent Acquisition and Tax prior to the requirement being approved on Vencuro. This further review will typically be completed in 5 working days.
  - 7. Contractor providing a substitute – The general policy is that Post Office have a right to reject a substitute (this will be more likely to generate an Inside IR35 status).
  - 8.1. Termination – Post Office and the contractor are required to provide 2 weeks' notice of termination.
  - 9. Stand Down Period – Post Office will annually instruct a stand down period over Christmas and New Year as an opportunity to reduce costs to the business. Additional stand down periods may be required dependent on activity levels.
11. Subject to ARC approval of the Contractor Engagement Policy, it will be implemented for new engagements with effect from 8<sup>th</sup> July 2024 with the aim of implementing for the



entire contractor population from 1<sup>st</sup> December 2024. This will align with the timing of the beginning of the new MSP contract.

12. Following the impact analysis of the current contractor population, a risk rating scale and associated actions were developed to assess the potential risk related to each contractor. The risk rating scale considers factors that determine IR35 risk. This can be found in Appendix B along with the number of contractors per each risk rating. The associated actions required to de-risk the current population are the options to:

- a. Convert to Inside IR35 before the end of the current contract.
- b. Convert to Inside IR35 at the end of the current contract.
- c. Continue with existing contract.
- d. Convert to FTC/Permanent contract.
- e. Leave at end of current contract; or
- f. Serve notice immediately.

13. Indicatively, analysis suggests that 33% of the current contractors would be required to convert to Inside IR35 before the end of their contract, 12% to convert at the end of their current contract, 3% will be served notice immediately and 46% will remain on their current IR35 status.

The below table provides the indicative impact on Outside IR35 contractors within SPM and Remediation Unit (as the two main users of contingent labour in POL):

Programme	Total Contractors	Action A	Action B	Action D	Action E	Action F	Total Impacted
SPM	112	51	7	2	0	0	60
Remediation Unit	84	23	16	0	5	2	46
Total	196	74	23	2	5	2	106

14. The business criticality assessment, contractor risk rating and contractor end date have been used to determine proposed action and the timing of that action for each contractor. Three proposals were explored as part of a project workshop and discussed with Steering Committee on 19<sup>th</sup> June:

- 1. Completion of all actions by the end of FY24/25
- 2. Completion of all actions by the end of November 2024
- 3. Complete all actions immediately in order of risk rating

15. Subject to the consideration of the financial impact analysis by the SEG, proposal 2 was the preferred approach of the Steering Committee. In addition to this date aligning to the timings of the potential new MSP, it also allows time for communication and engagement with impacted parties.

16. To support the financial impact analysis, external market research of the contractor labour market has been completed by the existing MSP for contingent labour for POL, Morson. The market assessment has shown that the expected cost impact of moving to an Inside IR35 approach to contractors is a 17% increase in day rates. This is lower than the expected 25% - 30% increase in day rates which would only be required for contractors with very specialist skill sets.



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17. The potential increase in costs for FY24/25 (from 1<sup>st</sup> July) could be up to c. £5m, of which up to £3.5m would be associated to key programmes (SPM, Remediation, and Inquiry). For FY25/26 this could be up to £4.4m, of which £3.5m would be associated to key programmes. These assumptions have been made based on the current contractor population only, and assuming they all receive up to a 30% increase in day rate for the duration of time the activity is required, which is higher than the expectation of the market assessment conducted by Morson.
18. In addition to the actions taken above, and as previously reported to ARC, Post Office has continued to resolve the procurement and governance issues in relation to the existing contracts for contingent labour MSPs.
- a. Board approved the Regulation 72 modification required on the existing contract with Morson, increasing the total contract value to £80m. The existing contract with Morson will end on 30<sup>th</sup> November 2024.
  - b. Board also approved the sourcing strategy for the re-procurement of the contingent labour contract with a 4-year contract value of £205m. This contract will start on 1<sup>st</sup> December 2024.
  - c. The late publishing of the contract award for the contract with Intelligent Resource was noted by Board. The existing contract with Intelligent Resource will end on 31<sup>st</sup> March 2025.
  - d. The operational implication of resolving these various issues is that from 1<sup>st</sup> April 2025, Post Office will have all contractors engaged through a single Managed Service Provider until 30<sup>th</sup> November 2028, which will allow the contract management requirements to be significantly simpler.



**Appendix B – Risk Rating & Actions Required**

<b>Rating</b>	<b>Detail</b>	<b>Active Contractors</b>
1	Outside IR35 and incorrectly deemed highly skilled & People Management AND/OR incorrect substitution answer, task sets location	3
2	Outside IR35 and either incorrectly deemed highly skilled OR People Management	130
3	Outside IR35 & Over 2-year tenure	29
4	Outside IR35	10
5	Inside IR35 & Over 2-year tenure	12
6	Inside IR35	153