

Off-payroll working rules from April 2020

(Lecture P1127 – 17.56 minutes)

The off-payroll rules (IR35) are designed to ensure that individuals who work like employees but through an intermediary, such as a personal service company (PSC), pay income tax and National Insurance Contributions (NICs) inline with the amount that an employee would pay if they were doing the same role.

The government believes that the cost of non-compliance with the off-payroll working rules in the private sector is growing and will reach £1.3 billion a year by 2023/24. Since April 2017 we have seen public authorities accounting for and paying income tax and NICs under PAYE to HMRC, on behalf of such workers. With PAYE receipts and independent research on off-payroll suggesting that this public sector reform has been effective in increasing compliance without impacting labour market flexibility, from 6 April 2020, the government now wants to extend the rules to the private sector. On 5th March 2019, HMRC published their consultation on the implementation of this reform, which runs until 28th May 2019.

April 2020 reform

The April 2020 reform will use the public sector off-payroll working rules as a basis to work from so clients and fee payers in both the public and private sector will be responsible for:

- determining employment status;
- deducting income tax and NICs as well as paying the employer NICs.

Any rule amendments that are made following this consultation will apply equally to the public and private sector.

Included parties

It is proposed that the new rules will apply to medium and large businesses in the private sector using the services of off-payroll workers but will exclude small businesses as defined by s382 CA 2006.

So a business that satisfies two or more of the following requirements:

Annual Turnover not more than £10.2m;

Balance sheet total not more than £5.1m;

Number of employees not more than 50.

For non-corporate entities where the balance sheet total may not be appropriate, two options are being considered:

1. Apply the reform to unincorporated entities with 50 or more employees and to entities with turnover exceeding £10.2 million; or
2. Apply the reform only to unincorporated entities that have both 50 or more employees and turnover in excess of £10.2 million.

HMRC Example 1

ABC Cash and Carry is a partnership specialising in the wholesale of goods to local businesses. The partnership employs 40 employees in various roles and in its accounting period ending 31 December 2019 it has a turnover of £8.7 million. ABC Cash and Carry has recently launched a website which allows their customers to place orders online. They engage an off-payroll worker through Agency Ltd to manage their website on their behalf.

It is now 6 April 2020 and the partnership must now decide whether or not the reform applies to them.

ABC Cash and Carry has fewer than 50 employees and less than £10.2 million in turnover. The partnership is considered small for the purposes of the reform under both options and does not have to apply the rules.

Small private sector organisations

Small private sector organisations will not be responsible for determining if the engagement is within scope of the off-payroll working rules. The off-payroll worker will be required to consider whether Chapter 8, Part 2 ITEPA 2003 applies to that engagement, as at present.

When an organisation becomes, or ceases to be small in an accounting period, for the purposes of the off-payroll working rules that change will apply from start of the tax year following the end of that accounting period.

HMRC Example 3

ABC Cash and Carry is a partnership specialising in the wholesale of goods to local businesses. The partnership employs 40 employees in various roles and it has a turnover of £8.7 million.

ABC Cash and Carry has recently launched a website which allows their customers to place orders online. They engage an off-payroll worker: Philip Johnson, of PJ Web Services Ltd through Agency Ltd to manage their website on their behalf.

It is now 6 April 2020, the partnership must now decide whether or not the reform applies to them. ABC Cash and Carry has fewer than 50 employees and less than £10.2 million in turnover. The partnership is considered small for the purposes of the reform and does not have to apply the rules.

As the reform does not apply to ABC Cash and Carry, it has not provided a determination to Agency Ltd or to the off-payroll worker Philip Johnson. All payments made by ABC Cash and Carry to Agency Ltd for Philip Johnson's services are for the full invoice amount and are not accompanied by a client status determination.

Agency Ltd are therefore not required to make any deductions for income tax and employee NICs, or pay employer NICs on any payments made to PJ Web Services Ltd for Philip Johnson's services.

When PJ Web Services Ltd is calculating its tax liabilities it will need to consider whether the engagement held by Philip Johnson with ABC Cash and Carry would have been one of employment were it not for the existence of Philip Johnson's company PJ Web Services Ltd.

If this is the case, then PJ Web Services Ltd would need to apply the reformed off-payroll working rules for engagements with small entities in the private sector, to be set out in Chapter 8, Part 2, ITEPA 2003.

Additional points

Anti-avoidance provisions will ensure that parties connected to, associated with, or controlled by the client cannot take advantage of the provisions to exclude small private sector clients from having to consider the status of their off- payroll workers.

Responsibilities down the supply chain

Under the public sector rules, clients must provide a status determination to the party they contract with by the time the contract starts or before the off-payroll worker starts work. If requested, the client must provide their reasons for the determination in writing within 31 days of the request.

If the off-payroll working rules apply:

- the fee-payer is required to deduct income tax and NICs from any invoice amounts and to pay it to HMRC.
- the off-payroll worker is required to inform a fee-payer of the nature of the structure they are working through as well as information to allow it to correctly account for Pay As You Earn (PAYE).

The government considers it necessary to legislate to ensure that the determination and the reasons for that determination are passed down to all parties within the labour supply chain, to ensure they comply with their obligations.

They are proposing that:

1. The client must provide the off-payroll worker as well as the party they contract with (e.g. an agency) the status determination for each engagement;
2. Status determination and reasons for that determination are passed down the contractual chain at, or before, the time they make the first corresponding payment;

3. Off-payroll worker and the fee payer have a right to ask for reasons for the determination directly from the client.

This proposal will ensure fee-payers who are further down the labour supply chain have the information they need to comply with the rules. The government wants to know more about typical labour supply chains and the role of any intermediary parties in the chain, in particular where more than one agency or party exists between the client and the worker's PSC. The government appreciates that, if the supply chains are long, a "short-circuit" approach may simplify the information flow, with the fee-payer receiving the determination directly from the client.

Offshore PSC

Where the organisation paying the worker's PSC is based offshore, the fee-payer responsibilities move up the supply chain to the next UK-based entity. The government is seeking views on how the engager may be in a position to identify this fee payer.

Where a potential fee payer has not received a determination, it would not be required to make any income tax and NICs deductions, or pay employer NICs, until such a time as it has received a determination.

Non-compliance

Chapter 10, Part 2 ITEPA 2003 provide for income tax and NICs to be transferred from one party to another where a client fails to provide a determination. Extending these existing provisions would provide an effective mechanism for preventing and addressing non-compliance with the rules following the April 2020 reform.

- Where HMRC does not receive the tax due, the liability will initially rest with the party that has failed to fulfil its obligations, until such a time that it did meet those obligations. This means that liability would move down the labour supply chain as each party fulfils its obligations. For example, if an agency in the chain failed to send on the determination that agency would be liable for any income tax and NICs due. Similarly, if a fee-payer, having received the determination failed to make deductions from any payments made to the worker's PSC then it would become liable.
- If HMRC were unable to collect the outstanding liability from that party, for example, because it ceased to exist, the government proposes that the liability should transfer back to the first party or agency in the chain.
- Where HMRC could not collect from the first party or agency it would ultimately seek payment from the client.

The advantages of this approach are that it would provide a clear incentive for all parties to comply with their obligations and to ensure a determination is passed fully down the chain. This approach would also encourage all parties to contract with reputable and compliant firms and ensure that appropriate due diligence is undertaken before the start.

Status determination disagreement

The government understands that in some circumstances an off-payroll worker or fee-payer may disagree with a client's status determination.

Where the fee-payer or off-payroll worker have not received the reasons for the status determination together with the status determination, the government thinks it is appropriate to provide the off-payroll worker and the fee-payer with the right to seek the reasons for the status determination directly from the client. This would be the first step in seeking to resolve status disagreements.

Additionally, it may be necessary for a process to be put in place to allow for determinations to be challenged. The current proposal is for clients to develop and implement their own processes to resolve disagreements based on a set of requirements to be set out in the legislation. They believe that public sector and medium/large-sized private sector organisations are likely to already have HR processes in place either in-house or sub-contracted to relevant service providers for managing workplace disputes. The government would expect the process to consider evidence put forward by the off-payroll worker and/or fee-payer, advising the party of the outcome of that consideration and the reasons for that outcome.

Accounting for tax and NICs

Under the proposals, where the rules apply, the process will work as it currently does for the public sector.

- The fee-payer is the deemed employer for income tax, NICs and Apprenticeship Levy purposes but will not be required to make deductions for student loan payments;
- The fee paid to the PSC is the off- payroll worker's employment income;
- The employment income will be the VAT exclusive amount paid to the worker's PSC.
- The off-payroll worker must provide their NI Number, tax code and identity details to enable the right tax to be deducted;
- On or before the fee-payer makes payment, the fee-payer must complete the RTI process and notify HMRC of the amount of the taxable earnings and the tax and NICs deducted.

The deemed employment relationship does not result in employment rights or statutory payments obligations for the deemed employer or fee-payer.

Employment Allowance

All employer NICs paid as a result of deemed employment income are excluded liabilities for the purposes of the Employment Allowance. They would not be able to claim the Employment Allowance against secondary Class 1 NIC liabilities arising from the payment of deemed employment income.

5% allowance

As with public sector engagements the worker's PSC will no longer be permitted to deduct a 5% allowance in relation to engagements with medium and large-sized clients.

Contracted out services

The off-payroll working rules require a worker to personally perform, or be under an obligation to personally to perform, services for the client.

Private sector organisations that contract-out services to a third party will not be required to apply the off-payroll rules, as for public sector bodies. In such cases, the third party would be required to consider whether the off-payroll working rules apply, and if they do, it will be responsible for deducting and paying the appropriate tax and NICs

Agency legislation

Where an agency contracts directly with the worker as an employee and operates tax and NICs, or engages them on a self-employed basis but operates tax and NICs under agency rules, then the off-payroll working rules do not apply. (See Chapter 7, Part 2 ITEPA 2003).

Umbrella companies

Where an umbrella company employs the worker directly as an employee and does not contract with the worker's PSC, the off-payroll working rules do not apply. If the worker's PSC receives payments for the off-payroll worker's service through their PSC then the off-payroll working rules will apply.

Off-payroll working rules taking precedence

Where the conditions in the off-payroll working rules apply, these rules will take precedence over the managed service company rules in Chapter 9, Part 2 ITEPA 2003 and the rules in the construction industry scheme.

Check Employment Status for Tax (CEST) service

The CEST service was launched in 2017 and the government believe that it is able to determine employment status in 85% of cases. An enhanced CEST service will be available before the reform is implemented in 2020 and HMRC will produce an education and support package to:

- give relevant information to those who will need to apply the off-payroll working rules, such as: HR directors, hiring managers, and off-payroll workers so they can act on the changes in time for April 2020;
- meet the needs of different users. For example clients will be pointed towards specific guidance on making the status decision, fee-payers to guidance on operating payroll, and off-payroll workers will have easy access to guidance specific to them, such as how to apply the existing rules when providing their services to small clients.

Actions to take now

The government recommends that those affected by the reform should start now to:

1. Review current engagements with intermediaries, including PSCs and agencies that supply labour to them;
2. Review current arrangements for the use of contingent labour, particularly within the organisation functions that are more likely to engage off-payroll workers;
3. Put in place comprehensive processes, across procurement, HR, tax and line management perspective, to ensure consistent decisions on employment status;
4. Review existing systems to see if they need to make any changes.

<http://www.gov.uk/government/consultations/off-payroll-working-rules-from-april-2020>