

Off-payroll: Impact on worker and PSC (Lecture B1248 – 14.20 minutes)

Summary of the rules post 5 April 2021

Client	Who assesses the worker's employment status?	Who deducts PAYE/NIC where appropriate?	When applicable?
Public sector	Client	Fee-payer	From 6 April 2017
Large or medium-sized: private sector	Client	Fee-payer	From 6 April 2021
Large or medium-sized: private sector	PSC	PSC (under IR35)	Until 5 April 2021
Small: private sector	PSC	PSC (under IR35)	Unchanged

Example

Donna runs Donna Enterprises Ltd ("DEL"), of which she is the 100% shareholder. It has a year-end of 5 April and is registered for VAT.

DEL enters a one-year contract for Donna's services with Westwich Consultancy plc ("Westwich") in April 2021.

Westwich gives Donna a Status Determination Statement, stating that the off-payroll working rules apply.

DEL invoices Westwich for the agreed fees of £2,500 /month plus VAT.

DEL has other income in y/e 5 April 2022 of £18,000 plus VAT, derived from Donna's sundry private sector assignments for non-small clients. All these clients have issued Status Determination Statements confirming that this work is outside the off-payroll working rules

What are the tax issues here?

Payments from Westwich

Westwich will treat Donna as an employee for employment tax purposes and will therefore need her NINO to set up a payroll record.

Although DEL will invoice Westwich for £2,500 plus £500 VAT per month, it will not receive this amount. Westwich will withhold income tax and employee's NIC from the £2,500 and pay them over to HMRC through the PAYE system. Unlike when calculating an IR35 deemed payment, there is no 5% deduction for general expenses. All of the ex-VAT fees are subject to payroll taxes. In addition, Westwich will need to pay employer's NIC @13.8% on the £2,500 fees, to the extent they fall above the 2021/22 monthly nil rate 'secondary threshold' of £737.

The monthly ex-VAT amount received by DEL from Westwich can be paid to Donna through DEL's payroll under RTI, without any further deductions. It should be recorded on an FPS as non-taxable income and the amount of gross taxable employment income recorded reduced accordingly.

Note: If running a payroll, to report non-taxable income, you should use the FPS data field 58A: Value of payments not subject to tax or NIC in pay period.

Alternatively, this income from Westwich can be drawn as a tax-free dividend from DEL.

Both methods of withdrawing the funds from DEL avoid a double charge to tax on the earnings, which suffered deduction of payroll taxes by Westwich.

Payment for other work

The £18,000 plus VAT billed for the other work will not suffer any deduction of payroll taxes by the clients; it will be paid gross.

As the payments are from non-small clients, there is no IR35 risk for the PSC.

These fees can be withdrawn from DEL flexibly by Donna, either

- as salary (while accounting for appropriate payroll taxes); or
- as dividends (which will be taxable, subject to the £2,000 dividend allowance).

At the year end

At the end of the tax year, Donna will receive two P60s: one from Westwich and one from DEL. The latter will not include the income passed on to her by DEL for the Westwich work.

The taxable income from both P60s will need to be included as earnings on Donna's tax return.

Accounting and tax for DEL

Accounting: Although the contracted fees for the Westwich work are £2,500 per month, an adjustment is required to this figure to write off a part of the debtor balance that will not be received by DEL, due to the withholding of payroll taxes.

Corporation tax: The net income from Westwich that is included in the accounts can be omitted when calculating the profits for corporation tax purposes. This is because it is treated as employment income of Donna and has already been taxed accordingly. The £18,000 income from other engagements will be included in the corporation tax computation, along with normal allowable expenses of DEL.

VAT: The new off-payroll working rules have no impact on the VAT position of DEL. Its total VATable turnover for the year will be (12 x £2,500) plus £18,000, i.e. £48,000. The payments received from clients, including Westwich, will include the full amount of VAT charged for which DEL will account to HMRC in the normal way.

Work for a small client

The rules become more complicated where some of the work done by the PSC is for a small client. Although this work would be outside the off-payroll rules, it potentially remains within the IR35 provisions.

This means that the PSC will need to self-assess whether there is an underlying employment relationship with the client; and if there is, calculate income tax and NIC on a deemed employment payment (unless a sufficient amount of this income has been passed on through the PSC's payroll to the worker).

Becoming an employee of your client

Note that, if a PSC has all its income dealt with under the off-payroll rules, there will be no income assessable to corporation tax. This means there will be no tax relief for any costs incurred by the company, such as stationery or professional fees. In such circumstances, a PSC is unlikely to continue to be a sensible vehicle for running your business.

Some contractors will understandably feel that, if their work is going to be subject to payroll taxes in any case, they may as well become a normal employee of that client. Although this may sometimes be an option, many clients will not offer it, as it would give you full employment rights (e.g. holiday pay and statutory sick pay). This is not the case with the off-payroll rules, where the client or other fee-payer merely pays over payroll taxes, but such statutory employment rights are given by the worker's own PSC.

Where contractors no longer need their PSC, it can be struck off or liquidated. The trade-off between the costs and tax-efficiency of these alternatives will need to be considered.

Updated HMRC guidance

HMRC has updated its guidance on off-payroll working in ESM10000, including:

- A new page on how to calculate a worker's statutory payment entitlement.
- Updates to existing pages to clarify:
 - when a status determination statement should be issued;
 - what constitutes reasonable care;
 - payroll processes; and
 - calculating statutory payment entitlements.
- Some smaller changes to clarify sections of the guidance, following feedback.

Contributed by Kevin Read