

Further reform to IR35 (Lecture B1178 - 13.12 minutes)

The off-payroll (IR35) rules were introduced in 2000 to ensure that individuals who were effectively employees but worked through an intermediary would not be able to avoid the income tax and National Insurance Contributions that would have arisen if they had been employees. The legislation failed to have much impact due to potentially affected individuals simply changing their contracts so they could argue that they did not fall within the rules. HMRC also failed to adequately police the system. Most of those who might have been affected would have been working through their own personal service companies and when the legislation was first introduced, it was the job of that company to make the assessment as to whether IR35 applied.

Changes were made from April 2017 where the end client of the intermediary was a public sector organisation. The responsibility for determining the applicability of the IR35 provisions reverted to the client. If the client determined that these anti-avoidance provisions applied, then a deduction for the payroll taxes had to be made by the person paying the personal service company. This saw around 60,000 recategorised as employees according to HMRC and additional revenue of around £400m raised in its first year of operation.

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. Because of the success that resulted from the changes in the public sector rules, it became almost inevitable that the changes would be extended to the private sector. It is the current intention for those changes to come in from 6 April 2020.

April 2020 reform

The April 2020 reform will use the public sector off-payroll working rules as a basis to work from and the amendments already announced (or any new amendments) will apply to both the public and private sector (although not the exclusion of small business).

Not all private sector businesses will be affected as 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 this will cover any corporate 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.

There are provisions as to how these limits apply when a company is a joint venture company or a subsidiary such that the other involved parties have to be taken into account. Note, that these rules apply to LLP, unregistered companies and overseas companies.

For non-corporate entities only the turnover is considered so a non-corporate business will be caught if its turnover is more than £10.2m.

There is also an anti-avoidance provision which takes account of the turnover of connected persons in determining whether the business is small.

Where the end client is a small private sector organisation, the personal service company remains responsible for determining whether IR35 applies.

The limits are tested in the financial period ending in the previous tax year. For the commencement of these rules, for companies and LLPs this will mean the accounting period ending before 6 April 2020. For individual and other partnerships, this will be the 2019/20 basis period figures. Going forward, for companies, if that company meets the conditions for two consecutive years, the new rules must be applied from the start of the tax year following the end of the second financial year when the conditions are met. For unincorporated businesses, the rules must be applied from the start of the tax year following the end of the calendar year when the conditions were met.

Responsibilities down the supply chain

Under the public sector rules, clients must provide a status determination to the relevant parties at the time the contract starts or before the off-payroll worker starts work. This is called the Status Determination Statement (SDS) and this must be given to the worker and any fee payer such as an agency. End clients must therefore make sure they have the appropriate processes in place to make and pass on the SDS to all relevant parties. In the absence of this, the end client will take on the responsibilities of the fee payer (if they are not the fee payer) to operate PAYE and NICs if applicable.

There has been an updated Employment Status Checker (called CEST) released in November 2019 to enable the status determination to be made. This is the subject to a separate module. HMRC has stated it will stand by the determination if the user has given correct answers.

One of the major criticisms of the public sector rules has been that there was no right of appeal against a status determination that the worker did not agree with. The draft legislation includes a right of appeal but not to HMRC. If the worker does not agree with their SDS there must be a process whereby this can be raised with the end client and the engager must respond within 45 days stating the reason why or why not they came to the conclusion and indicating if they have changed their view on further reflection.

HMRC will not get involved in any disputes but are planning to publish guidance on how a dispute will be resolved.

Non-compliance

The draft legislation allows for income tax and NICs to be transferred from one party to another where a client fails to provide a determination.

- 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.

Further points to note

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.

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.

The payment of tax and NICs to HMRC will follow the same model as applies 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.

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.

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.

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.

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.

Contributed by Ros Martin