

Off-payroll/IR35 rules: the basics from April 2020

Employment Tax

Tax voice



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Susan Ball and Lee Knight discuss the new Off-Payroll Working rules and the steps required to comply with them

**This article was written prior to the announcement that the implementation of the Off-Payroll Working rules are being delayed to April 2021.*

It has always been the responsibility of any organisation engaging an individual directly to determine the employment status of that individual. Where an employment relationship is deemed to exist for tax purposes, the individual must be

paid through the organisation's payroll to ensure appropriate deductions are made for tax and NIC. Employer's NIC is also then due.

Since 2000, where an organisation engaged a worker through an intermediary, sometimes the worker's own personal service company (or "PSC") directly, but this could also be via an agency, then the worker under the IR35 rules was supposed to assess whether they were in a relationship that was considered to be 'disguised' employment. If so, the worker was required to operate tax and NIC themselves on the employment income they were deemed to receive from that organisation under IR35.

It was widely accepted that the IR35 rules introduced in 2000 were not fully effective. In 2017 the rules for the public sector were therefore changed, and the amended legislation in Chapter 10 ITEPA 2003 was introduced. This legislation moved the decision for considering IR35 and assessing whether the worker was (for tax and NIC purposes) a disguised employee to the public sector end user of the worker's services, and where the worker was a disguised employee, the end user (or the fee-payer if different) became responsible for placing the worker on their payroll as a "deemed employee" so that tax and NIC could be operated on their deemed employment income via RTI.

The original IR35 rules introduced in 2000 continued to apply in the private sector. Non-compliance by workers and their intermediaries was still, however, an issue, with the cost to the Exchequer estimated to reach £1.3 billion a year by 2023-24, depriving public services of vital funds. As a result, and after consultation, at 6th April 2020, new legislation applies which extends and updates the public sector IR35 rules, primarily to include the private sector, but with changes for the rules for the public sector too.

HMRC have confirmed after extensive lobbying that they will initially take a light touch approach to penalties for noncompliance whilst these changes bed down. Organisations will not have to pay penalties for inaccuracies relating to these new IR35 rules in the 2020/21 tax year unless there is evidence of deliberate non-compliance. While this is welcome news, it is worth noting that organisations who are not compliant will, where relevant, still be held responsible for any underlying tax and NIC underpaid where the new IR35 rules are not properly applied, even where this relates to the 2020/21 tax year.

At the time of writing the final legislation is expected to be published in the Finance Bill on 19 March 2020. The broad thrust of the legislation is not expected to change but some changes to the details are expected as HMRC guidance and the current draft Finance Bill are not currently aligned.

Broadly, what are the new rules?

Under the new rules, end users of such worker's services will be required to assess whether these new IR35 rules apply to their engagements with off-payroll workers operating via an intermediary, for example their own PSC. These rules apply for both direct engagements (i.e. those where the end-user enters into a contract directly with the worker's intermediary) and those where the off-payroll worker is indirectly sourced via an agency or other third party. If engagements are caught (i.e. the relationship is a disguised employment and the engagement is "inside IR35") the fee-payer (being the party which pays the worker's intermediary/PSC) will be required to operate tax and NIC under PAYE on any deemed employment income arising under the engagement in relation to services provided by the worker from 6 April 2020.

These rules will apply to medium and large private sector organisations end-users and all public sector end users. For private sector end users who are small, that is any private sector end-user that qualifies as "small" under the definition set out in Section 382 of the Companies Act 2006 (new section 60A ITEPA 2003) the responsibility to assess the engagement will remain with the worker's intermediary/PSC under Chapter 8 ITEPA 2003. It should be noted however that small private sector organisations can still have obligations under the new rules if they are fee-payers or are otherwise involved in the labour supply chain for medium or large end users.

To be small the basic rule is that two of the following conditions must be satisfied:

- annual turnover must be not more than £10.2 million
- the balance sheet total must be not more than £5.1 million
- the average number of employees must be not more than 50.

In addition, a company is always small for its first financial year, and public companies are excluded from the small companies' regime. There are anti-avoidance provisions and rules which apply for joint ventures, groups and connected persons. Similar rules apply for LLPs, unregistered companies and overseas

companies. See the HMRC guidance at ESM10006 to ESM10009.

Key terms

- End-User - the receiver of the individual's personal service who will determine the status and could also be the feepayer if paying the intermediary or PSC directly. Sometimes referred to as the hirer, end-client, or engager.
- The Fee-Payer - often the organisation that supplied the worker and makes payment to the worker's PSC/intermediary on behalf of the client. But the fee-payer can be the end-user where the end-user engages the worker's intermediary/PSC directly.
- Intermediary - the individual's intermediary through which the individual/worker personally provides their services (for example, it could be a PSC or partnership or limited liability partnership)
- Individual/Worker - the off-payroll worker (or "OPW") who personally provides the service to the end-user.

Brief overview of the steps required for compliance

Under the new proposed rules the end-user must:

1. Determine if the contracted-out services exemption applies and, if it doesn't, whether the conditions of liability are met in respect of the intermediary. See Sections 61N, 61O and 61P Chapter 10 ITEPA 2003 and HMRC's guidance at ESM10003.
2. Undertake (taking reasonable care), and provide to the contractor and any third party with whom the end-user contracts for their service (such as an agency), with a status determination statement (an "SDS") setting out their assessment of the worker's status and the reasons for their assessment (see Steve Wade's article for further detail).
3. If the arrangement is one of "deemed employment" the fee-payer (which could be the end-user) must operate tax and NIC via payroll when paying the worker.
4. Set up a disagreement/appeal process which meets the statutory requirement so workers or the fee-payer are able to appeal the status determination if they disagree with it. End-users will need to respond to any appeals to their status determinations within 45 days of receipt. See Section 61T ITEPA 2003 and HMRC's guidance at ESM10015 (again, see Steve Wade's article for further detail).

5. Be aware of the transfer of debt provisions, which could result in a transfer of any tax and NIC liability due back up the labour chain, potentially back to the end-user, where the fee-payer or another party down the chain fails to satisfy their obligations.

The rules may also apply if working through an intermediary and the individual, intermediary, or client are:

- Overseas. However, please see below for an end-user who is wholly overseas; or
- Operate in the construction industry. These new IR35 rules take precedence over the Construction Industry Scheme rules.

Step 1. Conditions of liability

The legislation will only apply where the worker's intermediary satisfies specific conditions which will vary depending on the form of the intermediary. Some end-users appear to be overlooking this step and in practice the only way in every case to determine whether the conditions of liability are met is to ask the worker, usually in writing. Section 61U of ITEPA 2003 requires the worker to notify the client whether these conditions are met within 30 days of a request. Where the worker provides a fraudulent document the end-user cannot then be held responsible for any tax and NIC that should have been deducted (see HMRC's guidance at ESM10023).

Broadly the conditions of liability are:

Condition A: The intermediary is a company in which the worker has a material interest (broadly this is more than 5% of the shares, 5% of the votes, or entitlement to receive more than 5% of the assets).

Condition B: The intermediary is a partnership of which the worker is a member and is entitled (either alone or with members of the worker's family, which includes their spouse, civil partner or person with whom the worker lives as if they were spouses or civil partners) to at least 60% of the profits, or one in which the worker's share of the profit is linked to the payments under the contract and the majority of the partnership's income derives from the provision of services to a single client and its associates.

Condition C: The intermediary is an individual.

Step 2. How do end-users determine status?

The rules require the end-user to review the hypothetical contract with the contractor to determine the employment status. End-users can assess this in many ways, including using the HMRC Check Employment Status for Tax (or “CEST”) tool. How they reach their decision needs to be communicated in the SDS. (See Steve Wade’s article for further detail.)

HMRC launched an enhanced CEST service in November 2019 in response to stakeholder concerns about the previous CEST tool. Improvements have been made to the questions, language, and presentation, and guidance has also been added to help ensure that the questions are more clearly understood. See HMRC’s guidance at ESM11005 to ESM11170.

HMRC have also provided a specialist hotline to support end-user organisations in making employment status determinations. End-users can contact the HMRC helpline on 0300 123 2326.

Step 3. How do you operate PAYE on a “deemed employee” who is “inside IR35”?

Responsibility for operating tax and NIC under PAYE on the deemed employment income, and reporting this to HMRC under RTI, lies with the fee-payer. In calculating the deemed employment income, the direct cost to the intermediary of materials used, or to be used, in the performance of the services can be deducted. The deduction of expenses met by the intermediary can also be deducted but this is at the discretion of the fee-payer and must only take into account those expenses that are allowable under the legislation (see HMRC’s guidance at ESM10019 and ESM10028).

Off-payroll workers should be added to payroll like any other new-starter would be, although the new off-payroll worker marker must always be set. They should be issued a starter checklist so they can provide the fee-payer with the information they need to run payroll for them.

The declaration the worker chooses on the starter checklist will determine their PAYE tax code. Usually this will be declaration C as the worker will already have a primary employment with their intermediary. This would put them on tax code BR. A 0T week 1 / month 1 code would apply if the worker does not return the starter checklist.

Devolved powers that affect tax codes would apply as normal, for example Scottish rates of income tax.

The fee-payer will have to pay the employer's NIC and, where due, the apprenticeship levy too. The worker will be entitled to a P45 or P60 but is not specifically entitled to a payslip. However, the worker will often request a payslip or similar as evidence of the deductions the fee payer has made.

Under RTI employers are required to tell HMRC in their Full Payment Submission about income tax and NIC deductions they make from payments to employees, when or before those payments are made. This "when or before" RTI rule applies equally to off-payroll workers meaning that the timing of payments to off-payroll workers needs to be carefully considered so that RTI requirements can be satisfied.

Step 4. What is needed in the status disagreement process?

The legislation requires end-users to have a status disagreement process in place to allow for and deal with challenges made by workers and fee payers against Status Determination Statements the end-user has issued. (See Steve Wade's article for further details.)

What about end-users who are wholly overseas?

During the recent review of these new IR35 rules concerns were raised about how the rules will apply where the enduser is overseas. The Government has listened to those concerns and will amend the legislation to exclude wholly overseas organisations with no UK presence from having to consider these rules.

Where a medium or large sized private sector client is based wholly overseas, so there is no UK connection in the form of being UK resident or having a permanent establishment, then the rules at Chapter 10, Part 2, ITEPA 2003 do not apply (see HMRC's guidance at ESM10006). The worker's intermediary should consider whether Chapter 8, Part 2, ITEPA 2003 applies for these engagements (see HMRC's examples at ESM10026).

What about the transfer of debt provisions?

Where an end-user is using an agency to source workers, the rules make the fee-payer agency liable for accounting for employment taxes and NIC to HMRC if the worker is deemed to be an employee, based on the SDS issued by the enduser. The

rules provide that the liability will transfer back to the first party or agency in the chain, and potentially to the end-user, where there is a compliance failure by another party further down the chain and HMRC cannot collect the tax and NIC from that party. It is reassuring that the technical note (<https://tinyurl.com/w6pa867>) accompanying the draft regulations confirms that HMRC will not exercise their power to recover unpaid tax and NIC from the first agency or end-user where they cannot collect it from the party further down the chain as a result of a genuine business failure.

Does the end user need to confirm its size?

If a worker or the person an end-user contracts with is uncertain about the size of the end-user, it can formally request confirmation from the end-user. Knowing the size of the end-user will provide the certainty workers and other parties in the contractual chain need to understand whether Chapter 10, Part 2 ITEPA 2003 may apply. If the end-user confirms they are small the worker then knows they must consider Chapter 8, Part 2, ITEPA 2003.