Broadcast

FACTSHEET: OFF-PAYROLL WORKING/IR35

SPECIAL ISSUE

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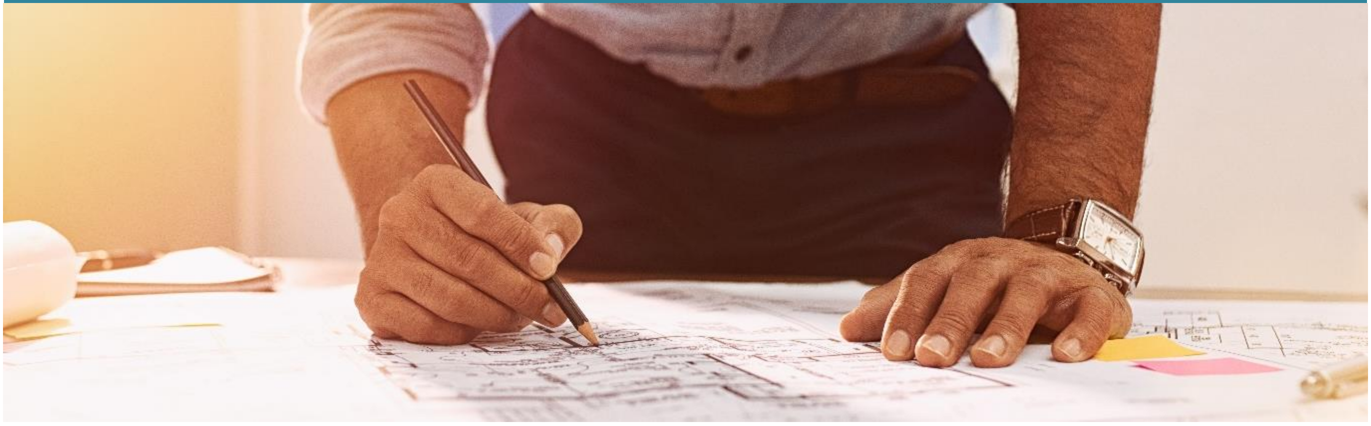
OFF-PAYROLL WORKING/IR35 – UNDERSTANDING THE CHANGES FOR BOTH THE WORKER AND THE CLIENT



New tax rules for individuals working via their own Personal Services Company for a medium or large business

From 6 April 2020, new tax rules are proposed for workers who provide their personal services via an 'intermediary' to a medium or large business. An intermediary may be another individual, a partnership, an unincorporated association or a company. The most common structure is a worker providing their services via their own Personal Service Company. This is the term used in this factsheet to summarise the rules which will apply to all workers, intermediaries and businesses.

Similar rules were introduced in 2017 for Public Sector Organisations receiving services from Personal Service Companies. The 2020 rules will use the 2017 rules as a starting point. This means, in practical terms, that the main principles have already been decided, but some aspects of the detailed operation of the rules will be decided in a consultation process; commencing 7th January 2020. Draft legislation has been published which will, subject to this consultation, be included in the next Finance Bill.

The effect of these rules, if IR35 applies to the worker, will mean:

- a medium or large business (or an agency paying the Personal Service Company on behalf of such a business) will calculate a 'deemed payment' based on the fees the Personal Service Company has charged for the services of the worker
- the entity that pays the Personal Service Company for the services must first deduct PAYE, employee and employer National Insurance contributions (NICs) as if the deemed payment is a salary paid to an employee
- the paying entity will have to pay to HMRC not only the PAYE and NICs deducted from the deemed payment but also undertake full reporting of the payment under PAYE
- the net amount received by the Personal Service Company can be passed onto the individual without paying any further PAYE and NICs.

The practical effect if these IR35 rules apply is that workers will no longer benefit from the potential tax advantages of receiving such income via Personal Service Companies.
There may also be pressure from businesses and/or agencies to renegotiate contracts, due to their increased cost of Employer NICs.
The new IR35 rules apply to amounts paid from 6 April 2020 and so may affect current contracts.

What is a medium or large business?
The Government intends to use an existing statutory definition within the Companies Act of a 'small company' to exempt small businesses from the new rules. Therefore the rules will exempt companies meeting any two of these criteria: a turnover of £10.2 million or less; having £5.1 million on the balance sheet or less; having 50 or fewer employees. If the business receiving the work of the worker is not a company, it is only the turnover test that will apply.

Who will decide if the rules apply?
The medium or large business will decide in all cases. The business needs to form an opinion as to whether, if the personal services of the worker were provided under a contract directly between the worker and themselves, the worker would be regarded as an employee of their business. This is the same kind of employment status test based on case law that businesses and agencies have to consider when they hire staff directly.

It is a matter of judgement whether the nature of and manner in which the services provided point to employment or self-employment. HMRC has provided an online Check of Employment Status for Tax tool (CEST) to help businesses decide the status of workers providing personal services to them. HMRC is currently working 'to identify improvements to CEST and wider guidance to ensure it meets the needs of the private sector'.

For reasons which are explained below, the business may be tempted to err on the side of employment, particularly if CEST indicates employment.
Here is the link to the Employment Status Service tool www.gov.uk/guidance/check-employment-status-for-tax.

Why have these rules been introduced?
The 2020 rules will replicate many of the effects of the 'intermediaries' legislation enacted in 2000, (often called the IR35 rules).

HMRC have found it difficult to enforce their view of the applicability of the IR35 legislation to many Personal Service Companies. Many view the risk of being 'caught' by IR35, and thus being required to pay PAYE and NICs, is outweighed by the benefit of company profits being paid out under a 'low salary, balance as dividends' regime, or to spouses or other family.

The new legislation therefore shifts the responsibility of the status decision to the business receiving the services of the individual. This means that the risk of non-compliance falls onto the business. If the business decides the new rules do not apply they may have to have a protracted dispute with HMRC which ultimately may go to a Tax Tribunal. If the Tribunal decides against the business, the business will have to pay over PAYE and NICs to HMRC, having already paid the gross fees to the Personal Service Company.

What can a worker do if they disagree with the business/agency deducting PAYE tax and NICs?
The Government will require the medium or large business when it makes a status determination to:

1. communicate the decision to the worker in a Status Determination Statement (SDS), and
2. give the reasons for that determination if requested by the worker.

This will be in addition to communicating the decision to the party with whom the business has contracted; for example an agency.

The business must take 'reasonable care' in coming to its conclusion.

If a worker disagrees with the decision they can use the CEST tool to see if they obtain a different conclusion. If they obtain a result which confirms self-employment they can discuss the results with the business, or they can contact us to discuss the matter. Even if they obtain an employment result, this does not necessarily mean the result is correct. HMRC state that the current tool is 'able to determine employment status in 85% of cases' which, of course, means it is not correct in 15% of cases. Many commentators consider the accuracy of the tool to be much lower.

HMRC is currently working with stakeholders to enhance the CEST tool and guidance on the use of CEST, but many commentators consider that the law on status is too complicated for a yes/no checklist to provide the right answer in all cases.

The Government will introduce a 'client-led status disagreement process' where you can make a representation to the medium or large business, where you believe that the conclusion mentioned in the SDS is incorrect. The medium or large business has 45 days, from when the representation is received, to review the decision and either confirm that decision or give the worker a new SDS with a different conclusion. If the business confirms the decision it must give its reasons for deciding that the conclusion is correct.

What is the tax effect on the worker?
The important point to appreciate is that the worker will be treated, in tax terms, as an employee of the entity that pays the Personal Service Company for their services. So if a contract ends during the 2020/21 tax year, the paying entity should send a P45 showing the total deemed payment and deductions for PAYE tax and NICs. If the contract extends over the 2020/21 tax year, the paying entity should issue a P60 to the worker showing the total payment and deductions in the 2020/21 tax year.

The worker will need to show the amounts on the P45 or P60 as an employment on the employment pages of their 2020/21 self assessment tax return.

The amounts of income tax recorded as paid on the P45 or P60 may well not be the correct amount of income tax payable. Please look at the first part of the example in the Appendix which illustrates how PAYE and NICs are deducted from the deemed payment by the paying entity.

The other important point to appreciate is that it is the Personal Service Company which is receiving the amounts from the paying entity. How can workers extract such income without further taxation? The draft legislation has special rules to allow workers to do so.

What procedures does a Personal Service Company need to follow if deemed payments are received?

The Personal Service Company will deduct the amount of the payment it receives, as well as the PAYE/employee NICs costs incurred, from its taxable income, so it will not be taxed twice.

Please see the second part of the example in the Appendix which illustrates the procedures a Personal Service Company should take in passing the net deemed payment to the worker.

What if a Personal Service Company has other contracts hiring out a worker's personal services?

Nothing is expected to change in respect of contracts a Personal Service Company has with small private sector clients. The possible application of IR35 needs to be considered but there is no change in the law regarding IR35. If contracts are not caught by IR35, we can help you decide on an appropriate profit extraction strategy for the profit from these contracts.

What if a worker becomes an employee, or subject to IR35 under the new system?

HMRC have issued a factsheet on 13/01/2020. In it they confirm that HMRC will NOT use information granted under these new rules to look at past arrangements, unless fraud or criminal behaviour is suspected. So if HMRC challenge any arrangement prior to 06/04/2020, they will do this based on submissions relevant to the period only.

If you need any further information or assistance with IR35 from either an individual or business perspective, please call us on **01753 888211** or email **info@nhllp.com** to discuss further.

APPENDIX

Example of potential operation of the IR35 (off-payroll) rules

This is an example of the likely effect of the operation of the rules based on how the rules for the public sector operate.

Derek provides personal services to a large business via his Personal Service Company, Derek Ltd. The business considers the off-payroll working legislation applies. The contract will end on 30 September 2020.

In 2020/21, Derek Ltd invoices the business £4,000 a month. There is no VAT and no expenses in the invoices.

The business would treat each of the monthly payments as deemed payments. Derek will need to provide the business with his National Insurance Number, address, date of birth and P45 if appropriate in order that they can set him up on their payroll.

As Derek has a ‘primary employment’ with his own Personal Service Company, the services he provides to the business are treated as a ‘secondary employment’. The business would initially operate tax code BR which means income tax is deducted at basic rate. Employee NICs would be deducted at normal rates on £4,000 a month. Employer NICs would also be payable by the business on the deemed payment of £4,000.

The business will report and pay PAYE and NICs to HMRC via their payroll. In due course, HMRC may issue the business with a tax code to use against future payments made to Derek Ltd.

When the contract ends on 30 September 2020, the business should send to Derek a P45 showing the total deemed payment and deductions for PAYE and NICs.

If the contract extends beyond the 2020/21 tax year, the business should issue a P60 to Derek showing the total payment and deductions in the 2020/21 tax year.

The total amount invoiced by Derek Ltd and recorded as gross deemed payments by the business is £24,000 (6 X £4,000).

Assuming the tax code BR does not get adjusted the net deemed payments total (based on rates and allowances for 2019/20):

	£
Amount invoiced	24,000.00
Less: PAYE - £24,000 at 20%	(4,800.00)
Less: Employee NIC – 6 x monthly NICs of £393.72	(2,362.32)
Total net deemed payments	16,837.68

The business will also need to pay employer NICs. The monthly amounts due will be £452.78 which total £2,716.68.

If VAT has been charged by Derek Ltd, the business would pay Derek Ltd £16,837.68 plus the VAT charged on £24,000.

Effect in Derek Ltd

The company will get relief from corporation tax for the VAT exclusive amount of the invoices ie £24,000.

Procedure if Derek Ltd pays Derek the net deemed payment through the payroll

Any amount of income paid to Derek up to £16,837.68 will have already been subject to deduction of PAYE and NICs. HMRC guidance is that the payment should be recorded on a "Full Payment Submission" as non-taxable income.

Procedure if Derek Ltd pays Derek the net deemed payment as dividend

Alternatively Derek can receive a dividend up to £16,837.68. This will not be reported as a dividend on his self assessment return.

Effect for Derek

Derek would be treated as having received the net deemed payment from the business in the 2020/21 tax year irrespective of whether he has received it as salary or dividend (or even if he has not received it from his Personal Service Company).

On his 2020/21 self assessment return he will record the information supplied to him from the business:

Employment income	£24,000
PAYE deducted	£4,800

There may be a tax repayment due to Derek if he has not utilised his personal tax allowance against other income. Alternatively income received from the medium or large business may attract a higher rate tax liability, if Derek has other taxable income.