OFF-PAYROLL WORKING

IR35

MARCH 2021

ARE YOU READY FOR THE CHANGES IN APRIL 2021

After the much delayed implementation, the rules regarding the responsibility for managing the compliance of Off-Payroll Working are changing with effect from 6 April 2021. An overview of the changes and actions required are set out below.

Introduction

Off-Payroll Working (or IR35 as it is often called) was introduced as a piece of anti-avoidance legislation in the year 2000 and is designed to assess whether a contractor is a genuine contractor or a "disguised" employee for the purposes of paying employment taxes. The situation that is covered by the legislation is as follows;

A is the company to whom C provides services through his/her intermediary personal services company (the end user)
B is (typically) C's intermediary company
C is the person providing services (contractor)

IR35 requires that if C would be A's employee but for providing his/her services through B, then B has to ensure that it makes appropriate income tax and NIC deductions on the earnings from A. This does not mean the person becomes an employee for employment law purposes, these rules are for tax law purposes only.

Where there is no intermediary company, this legislation does not apply. However, the process undertaken when considering whether IR35 applies may highlight some individuals who should be employees in any case and hence on the payroll rather than self-employed.

Why is there a change?

The Government estimates that there is 90% non-compliance under the current rules and hence this is seen as a good way to increase its revenue. In addition, it is considered that, given the complex set of rules, companies are more likely to be able to correctly determine the status of contractors than the individuals themselves. From HMRC's viewpoint, compliance will be easier to enforce by pursuing companies rather than the individual contractors.

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What is changing?

The rules governing IR35 are not changing, but the responsibility for compliance is shifting to the end user. Using the above analogy, A will need to determine the status of C, whereas currently it is C who determines his/her status. This change applies to large and medium sized companies, as defined in the Companies Act 2006, with an exemption for small companies. There are complex rules to determine the size of a company (which includes LLPs), but in very simple terms, if two of the three following conditions are met, the new rules will apply;

- Turnover in excess of £10.2 million
- Gross assets (fixed and current) in excess of £5.1 million
- More than 50 employees (including the IR35 contractors)

Certain companies are exempt from being small, even where they meet the above criteria, such as listed companies and various regulated companies. Care needs to be taken in group situations – again, in simple terms, if a small UK company has a medium or large sized parent, which could be an overseas entity, the UK company will fall into the new regime.

For non-corporates, their size is determined by the above turnover figure alone. It should also be noted that the Finance Bill 2020 clarified the position regarding end users based overseas - wholly overseas organisations with no UK presence are excluded from this legislation and hence the existing rules apply, such that it will be the responsibility of the individual's limted company to determine the IR35 status.

Determination of Status

There are three main status tests to consider whether someone is subject to IR35 or not as follows;

1. Mutuality of Obligation - is there an obligation on the part of the employer to provide work and is there an obligation on the part of the employee to accept work offered?
2. Control – what, how, where and when is the work done?
3. Substitution – can someone else step in to do the work, is there a substitution clause, can it be enforced in reality?

In addition, consideration should be given to the financial risks/equipment; who pays for PI insurance, professional subscriptions, is the contractor genuinely at risk of making a loss if the work goes wrong, who provides any equipment?

HMRC have developed an online tool, CEST (https://www.gov.uk/guidance/check-employment-status-for-tax), to assist companies with determining the status of a consultant; this has had some improvements over the past 12 months and is likely to continue to be refined. If all questions have been answered honestly, it can be relied upon and HMRC will accept its conclusions. However, if CEST gives an "in" IR35 answer, this does not need to be conclusive - the key to assessing the status of a contractor is to build a picture of what happens in practice. There are a large number of matters to consider which will help to build the picture based on the above status tests. Similarly, the tool can give an "unable to determine" status, so again a picture needs to be painted. The latest figures produced indicate this was the situation in 19% of all cases.

What needs to be done if a contractor or other party is in IR35?

If the conclusion of the end user is that the contractor is "in" IR35, this must be communicated to both the intermediary that the end user has contracted with and the contractor. This is done by way of a Status Determination Statement which must give both the conclusion and reasons for it. If this is not done, the obligation to deduct tax and NI remains with the end user. In addition, it is the end user's obligation to ensure that the parties within the supply chain are compliant and the communication is passed up the chain to the ultimate fee payer i.e. the final intermediary. This is less of an issue where there are only three parties involved but could be challenging should there be a long supply chain. In addition, whilst the guidance is not clear, the general view is that it will be good practice to communicate the findings to a contractor considered to be outside of IR35.

Where the conclusion is "in", there will almost certainly be a financial impact for both the end user and the contractor. Commercially it is likely that the two parties will need to discuss the position and agree a revised contract from a financial perspective.

Once the findings have been communicated, the contractor can appeal the decision and the end user has 45 days to respond. As the end user is the only party who has to reconsider the findings, and it is their decision initially, this is not seen as a particularly useful process, except to add to the administrative burden of the end user.

As above, it is the obligation of the final intermediary in the chain to deduct income tax and National insurance. In practice, the contractor will continue to invoice the end user via the intermediary and the company will pay the intermediary company. The intermediary company will put the individual on the payroll, enter the gross "salary" as the invoice amount, excluding VAT and expenses, deduct the necessary tax and NIC, and then pay the contractor the net salary plus the VAT and expenses per the original invoice. The tax and NIC deductions will be paid over by the intermediary as part of the normal payroll deductions to HMRC, which will include employer's NIC, with the payment reported as part of the regular Real Time Information payroll reporting.

What if you get it wrong?

If HMRC disagree with the tax treatment adopted by the end user for a contractor, the company will be liable to interest (currently at 2.6%) and penalties. The penalties can range from 0% to 100% of the tax and NIC payable, depending on the type of behaviour adjudged by HMRC, which ranges from reasonable care (0%) to deliberate and concealed (100%). However, HMRC have confirmed that for the first 12 months, penalties will not be payable for inaccuracies, unless there is evidence of deliberate non-compliance. If this is the case, the businesses will be "named and shamed".

Assuming that the end user agrees (or is unable to argue otherwise) with HMRC's assertions, the interest (and penalties) are payable on the employer's NIC, employee's NIC and income tax (even though the income tax is highly likely to have been paid elsewhere).

Current Action Required

In order to be ready for the new rules, the following actions should be undertaken;

1. Determine whether the new rules apply to you
2. If they do, look at all arrangements where services are supplied by a contractor and assess the contractor's status
3. Review all current contracts between your business and intermediaries
4. Consider whether new contracts that are going to be issued are compliant with IR35
5. Issue Status Determination Statements with explanations

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6. Review the impact on the business from a cost perspective and a potential loss of contractor perspective
7. Consider putting indemnities in place along the supply chain
8. Communication with all parties involved

Conclusions

The off-payroll working is certainly not an easy piece of legislation to follow, as has been demonstrated by various court cases, albeit most of which have been lost by HMRC. As the introduction of these new rules was postponed close to the previous implementation date of 1 April 2020, businesses are hopefully now advanced in their planning and actions to be undertaken in respect of the legislation.

By their very nature, the contractors will not be on the payroll and hence "payroll" will need to liaise with "finance" to ensure the status of each relevant individual is considered.

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