

NEW IR35 RULES from April 2020

The government is extending the off-payroll working (IR35) rules to the private sector from 6 April 2020, three years after the changes were made across the private sector, effectively bringing contractors into income tax and National Insurance contributions (NICs) for the first time. Previously these workers paid their own income tax and NICs, outside of the PAYE system.

The private sector off-payroll rules largely replicate the existing legislation for the public sector, but they only apply to medium or large-sized businesses in the private sector that engage workers operating through intermediaries.

An intermediary is usually a worker's personal service company (PSC), but could be a partnership, a limited liability partnership (LLP), a managed service company or even an individual.

The effect of the legislation is to shift responsibility for determining whether the IR35 rules apply from the worker's PSC to the organisation or business using the worker's services (the end user client).

Where the end user client determines the worker falls within the IR35 rules, the responsibility for applying and deducting the correct PAYE and NICs will lie with the fee payer.

The end user client and the fee payer may or may not be the same organisation. It could be a third party if, for example, the services are provided via a recruitment agency.

Small business exemption

The new rules only apply to medium and large businesses outside of the public sector. The small business exemption uses the existing definition of 'small company' in Companies Act 2006 (CA 2006) for incorporated businesses.

So, to be exempt from the rules, the company must meet at least two of the following requirements:

- annual turnover of not more than £10.2m;
- balance sheet total of not more than £5.1m;
- average number of employees no more than 50.

For unincorporated businesses there is a simplified test so only the annual turnover test of £10.2m applies.

Assessment is made to the financial period ending in the previous tax year.

For companies and LLPs this will be the period ended before 6 April 2020 for the 2020/21 tax year.

For individuals and partnerships, they will assess using their 2019/20 turnover for the 2020/21 tax year.

Going forward from 6 April 2020, for incorporated businesses, if the 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 filing period for the second financial year when the conditions were met.

If the simplified test is met and the new rules apply, they must be applied from the start of the tax year following the end of the calendar year when the conditions were met.

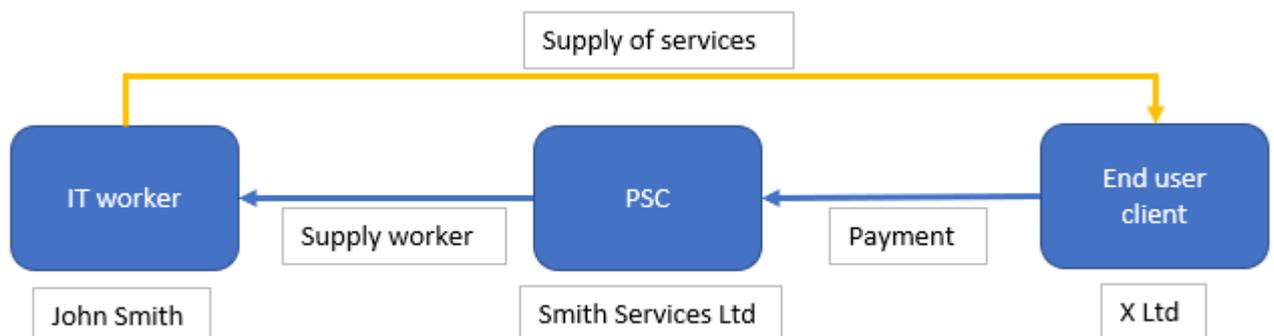
If a parent company does not qualify as 'small' under the test above, then none of its subsidiaries can qualify as small.

End user client and the fee payer

The end user client (end user) is the organisation that is ultimately receiving the worker's services. The end user is responsible for determining whether the worker would have been regarded as an employee if they were engaged directly.

If the end user determines the IR35 rules apply, the fee payer is treated as the employer for purposes of PAYE and NICs. The fee payer is the business paying the PSC for the worker's services.

For example, where a worker supplies IT services to X Ltd through their PSC.

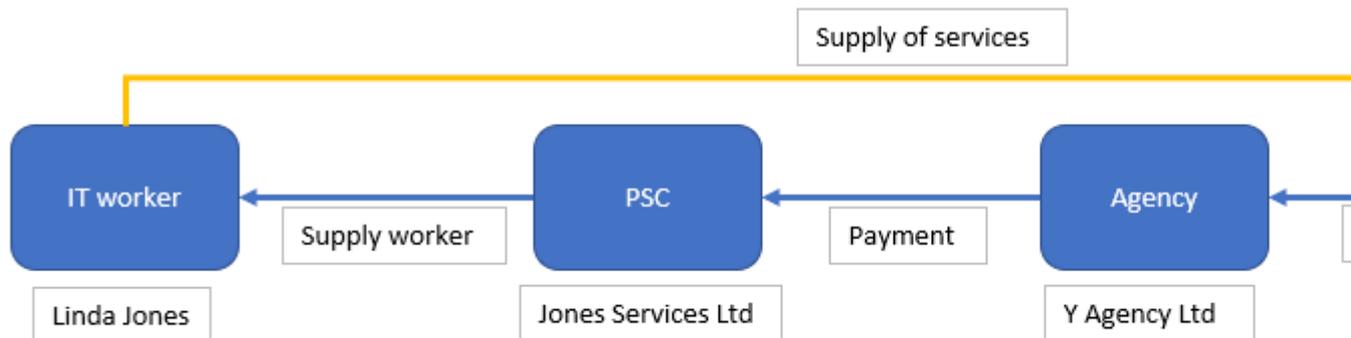


X Ltd is end user as they are receiving the individual's IT services. X Ltd is also the fee payer as it is responsible for paying the worker's PSC.

As the end user, X Ltd is responsible for reviewing the worker's engagement status and determining whether the individual falls within the IR35 rules. If X Ltd decides the IR35 rules apply, it will be liable, as the fee payer, for deducting income tax and NICs from the payments made to the PSC. It will also be liable for secondary Class 1 NICs and remitting payments and information under real time information to HMRC.

Where the worker is engaged via an agency, the obligation to deduct PAYE and NICs would fall on the agency or the organisation making the payment to the PSC.

For example, where a worker supplies IT services to Z Ltd through their PSC.



Z Ltd is the end user and makes payment to the agency. Z Ltd is therefore responsible for assessing if the IR35 rules apply and determining the worker's status.

If Z Ltd decides the IR35 rules apply, the agency as the fee payer is responsible for making the income tax and NIC deductions.

Status determinations and the status disagreement process

The draft legislation requires the end user of services to make a status determination and provide a status determination statement (SDS) to both the worker and the fee payer, such as an agency, that it contracts with.

End users will need to ensure they have the appropriate processes in place to make and pass on the SDS to the worker and any third party. If this obligation is not met, then the end user will take on the responsibilities of the fee payer to operate PAYE and NICs if applicable.

There is a requirement for the end user to apply reasonable care when reaching a determination to prevent them making blanket determinations. If the end user has failed to take reasonable care in making a status determination, the SDS is not valid. They will then become responsible for PAYE and NICs.

A status determination disagreement process must be set up by the end user.

If the worker or the fee payer make representations to the end user that the status determination statement is incorrect, the end user will be required to complete the disagreement process and inform the worker or fee payer of the outcome within 45 days of receipt.

If the end user fails to do this within 45 days, they will be treated as the fee payer and will be responsible for any PAYE and NICs due.

HMRC has stated it will set out in guidance how a client can fulfil its obligation to take reasonable care and how it might implement the status disagreement process.

CEST

HMRC provides an online employment status tool, Check Employment Status for Tax (CEST) to help determine whether a worker should be classed as employed or self-employed.

However, this tool does not currently consider all of the factors relevant to a worker's status and so it should not be solely relied upon to reach a conclusion.

HMRC has stated that an improved version of the CEST tool will be available before April 2020.

Public sector end user

The off payroll working rules which came into force in the public sector in April 2017 continue to apply to all public sector bodies not just medium and large organisations.

One area that was not covered by the public sector reforms but is included in the private sector draft legislation is the right of appeal where the worker does not agree with a determination that employment would apply. This right of appeal will apply to individuals working for public sector engagers as well as private businesses from April 2020.

Transfer of liability provisions

The controversial transfer of liability provisions included in the draft legislation in Finance Bill 2019-20 will potentially allow HMRC to transfer liability to an agency at the top of the labour supply chain or to the end client, where there is non-compliance further down the supply chain and it is not possible for HMRC to collect the amounts due from the party liable.

HMRC has stated that these transfer of liability provisions will only be applied in certain circumstances, such as deliberate default or tax avoidance. Guidance will be published to provide more clarity on where HMRC will use these powers.

It is important at this stage, however, to make sure that the end user and the first agency understand who the parties in their labour supply chain are and ensure that parties further down the chain are aware of and meet their obligations under IR35.

Begin to prepare for the changes

Accountants and advisers need to identify which of their clients will be affected by the new legislation and to alert those clients to the changes.

Where the client is an end user in the private sector, and the small business exemption does not apply, they will need to review their use of PSCs and, if it is appropriate, to introduce updated contracts that meet the need of the organisation in the event that IR35 will apply to a particular arrangement.

Once all PSC use has been identified, current arrangements need to be reviewed, and processes and procedures established to ensure that an IR35 assessment is completed

before engaging with a worker via a PSC. The need to train and support the relevant staff involved in this process going forward should also be considered.

Businesses also need to communicate the changes to their workforce and ensure that the contractors they work with are fully aware of how the changes will affect them.

Where the client is a PSC, it is important that they understand the potential impact the changes could have on their business, and the options open to them where they disagree with a SDS.

It has been reported that some large organisations have imposed a blanket ban on contractors working through a PSC; the contractors having been given the option of becoming an employee or not working for the organisation.

In some cases, it may be that the PSC is no longer required and it may be necessary to consider winding-up the business.

The new rules will have a significant impact on how private sector businesses engage with off-payroll workers. However, while businesses need to understand the impact of the new rules and implement any necessary changes ready for April 2020, it should be noted that the draft legislation has not yet become law and may be subject to change.

About the author

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