Off-payroll working (IR35)

From 6 April 2021, new tax rules for off-payroll working, often referred to as IR35, will be extended to cover both public and private sector contracts.

This change will represent a major upheaval for sectors heavily reliant on subcontractors. Medium and large end clients face increased administration and obligations. For fee-payers there will be a real squeeze on margins with Employer's NIC costs and payroll running costs. Affected subcontractors' take-home pay will be significantly reduced by employment taxes without the statutory protections of actual employment.

IR35 applies where an individual would have been an employee of the end client for tax purposes if it was not for the other parties in the supply chain. HMRC introduced similar rules in April 2017 for public sector contracts including local government and NHS.

Currently when a subcontractor takes on a private sector contract through their own personal services company (a PSC), the decision on whether IR35 applies or not is taken by the PSC. Often main contractors and end clients insist that the subcontractor uses a PSC to reduce their own tax risk.

What is changing?

New off-payroll working ("OPW") rules will apply from April 2021 to personal services provided to an end client. The responsibility for assessing and determining the employment status of the individual workers rests with the end client, rather than the PSC or other intermediary. This change could result in more engagements being assessed as within IR35 with increased taxes payable and administrative pressures.

It is important to note that whilst an arrangement may be deemed employment for IR35 purposes it does not mean that the worker will be afforded worker's rights from the end client. Statutory sick pay, holiday pay and other employment rights remain the responsibility of the PSC.

Who is affected?

Extended IR35 rules apply to all engagements with public sector end clients and in the private sector where the end client is medium or large-sized, currently defined as meeting two (or more) of the following three conditions:

- Annual turnover of more than £10.2 million
- Balance sheet total of more than £5.1 million
- More than 50 employees

This is a familiar concept as applied to companies. For IR35, the limits also extend to non-corporate organisations such as charities and partnerships.

How does it work if the engagement is within IR35?

The end client prepares the SDS and provides a copy to the worker and to the organisation next to it in the labour supply chain. Each link in the supply chain passes the SDS to the next until it reaches the "fee-payer". This is the organisation which pays the PSC. Where a contract is in IR35 from April 2021, the fee-payer must add the worker to their payroll and treat the amount on the PSC invoice (excluding VAT) as employment income deducting PAYE and Employee's NIC and paying Employer's NIC to HMRC. Apprenticeship Levy may also be payable by the fee-payer.

For small private sector engagements, the end client is not required to assess the status. The PSC must decide the IR35 status and if within IR35 pay PAYE and NIC on a 'deemed employment' payment calculated at the end of each tax year.

Labour Supply Chain

Worker → Personal Service Company → Fee-payer → End client

Worker

The individual providing personal services.

Personal Service Company (PSC)

The intermediary immediately above the worker and the entity that transfers value to the worker. Typically, this is a limited company with a single shareholder director who is also the worker. This position could equally be held by a partnership or an LLP.

Fee-payer

This refers to the entity that pays the PSC or other worker's intermediary. It must operate payroll on the amount invoiced by the PSC if it receives a deemed employed SDS from the end client. If there are expenses included in the invoice these are not taxed as employment income if they would have been reimbursed as business expenses for an employee, e.g. non-commuting travel.

End client

The entity receiving the personal services of the worker.

It must identify those workers where it has a responsibility to assess their employment status. The Status Determination Statement (SDS) must be shared with the worker and the next organisation in the supply chain.

HMRC provide an online tool for checking the employment status of a worker; www.tax.service.gov.uk/check-employment-status-for-tax/reason-for-using-tool. Regular updates are made to this tool, so it is important to ensure the most recent version is being used.

It is not mandatory to use the HMRC tool and it does not always give an appropriate result. The end client must take reasonable care when assessing. The worker and fee-payer can dispute the SDS.

Practical impact on businesses

These new rules will create an additional administrative burden for the end client and additional tax costs for the fee-payer and worker. It is expected that the rules will be applied cautiously by end clients who may have multiple engagements to assess. This could result in disputed assessments, protracted negotiations and additional tax costs.

The end client must take reasonable care in making their assessment, and the worker or intermediary is able to dispute the end client's decision. The end client must respond within 45 days to such disputes.

If the fee-payer does not pay the PAYE and NIC to HMRC, the liability transfers up the supply chain, potentially to the end client. Even if the PSC already applied IR35, the new rules could cause cashflow issues for the worker with taxes deducted at source from the full payment amount, as compared with the end of the tax year.

How can we help?

Whatever stage in the labour supply chain you are at, we can assist in getting to grips with IR35.

- Working with end clients and fee-payers to ensure that they have systems and processes in place to comply with their obligations and make appropriate decisions
- Assist where there are disputed assessments to understand options and work to a resolution
- Operating payroll for IR35 workers
- Review existing contracts with reference to IR35 and advise on new contracts negotiations

For more information please contact us using the below contact details.

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