

## PERSONAL SERVICES COMPANIES – TAX CHANGES

---

### HMRC launches consultation on proposed changes to IR35

#### Background

The off-payroll working rules – commonly known as IR35 – are intended to ensure that individuals who work like employees pay broadly the same employment taxes as employees, regardless of the structure they work through. The off-payroll working rules apply where an individual provides their services through an intermediary (often a "personal services company" (**PSC**)) to another person or entity.

The government announced during the 2018 Budget that, in order to increase compliance with the existing off-payroll working rules in the private sector, businesses (rather than the intermediary) will become responsible for assessing the employment status of the off-payroll workers they engage and accounting for any necessary employment taxes.

The government has now published its consultation document on proposed changes to the off-payroll working rules which will take effect from April 2020. This will bring the private sector in line with the public sector, although it is worth noting that the changes that the government is proposing in the consultation will apply equally to engagements in the public sector and will amend the existing law governing off-payroll working in the public sector which was subject to fundamental change in April 2017.

#### HMRC consultation

The consultation asks for views and information on a number of subjects, including:

- ▶ the scope of the reform and impact on non-corporate engagers;
- ▶ information requirements for engagers, fee-payers and personal service companies; and
- ▶ addressing status determination disagreements.

It also sets out how businesses can prepare for reform, and sets out HMRC's plans to provide education and support for businesses that will be in scope of the change.

**The consultation is open for comments until 28 May 2019.**

#### Key proposals

The key proposals from the consultation are:

- ▶ the end user of the services (**client**) will be required to make a determination of an individual's (**worker**) employment status and communicate that determination to both the worker and the entity it engages with (often, but not always, the PSC); and
- ▶ if the client determines that the worker is an employee for tax purposes, the organisation paying the worker's personal services company (**fee-payer**) – who may or may not also be the client, depending on the complexity of the supply chain – will need to account for income tax and NICs (employees' and employer's) in respect of such payment.

#### Who will the new rules apply to?

The new rules will apply to all public sector and medium and large-sized private sector clients. A corporate client that satisfies two or more of (i) annual turnover of not more than £10.2 million; (ii) balance sheet total of not more than £5.1 million; and (iii) number of employees not more than 50, will be excluded from the new rules and the current rules will continue to apply to these smaller companies.

Where the client is a non-corporate entity, the consultation proposes two alternative options for determining who is caught by the new rules:

**Option 1:** apply the new rules to all unincorporated entities with 50 or more employees and to entities with a turnover exceeding £10.2 million; or

**Option 2:** apply the new rules to all unincorporated entities that have both 50 or more employees and a turnover exceeding £10.2 million.

The consultation asks for comments on which of these options would be preferable for non-corporate entities.

## Communication responsibilities

The new rules will require a client to provide its employment status determination directly to:

- ▶ the party that the client directly contracts with (which is currently the case for public sector clients); and
- ▶ the worker.

In addition, the client must give the reasons for the determination to the party it contracts with and, on request, to the worker. It will then be the responsibility of each party in the chain to cascade the determination and the reasons for the determination along the supply chain.

**All communication must take place at, or before, the first payment under the contract.**

The government has also suggested an alternative "short-circuit" approach whereby the client is also required to give the determination and, on request, the reason for the determination directly to the fee-payer. The government considers that this may be a better approach where the supply chain is long and complex and the communication chain is therefore more likely to fail. Although, the government recognises that where the fee-payer is off-shore and the fee-paying responsibilities have therefore moved up the supply chain to the next UK entity, the identity of the fee-payer may not be known to the client.

Again, the consultation asks for comments on this approach and, in particular, if such an approach would place a significant burden on the client.

## Liability where communication responsibilities are not met

In order to ensure that the extended information requirements are effective, the government also proposes to modify the rules that determine when the liability for income tax and NICs should be transferred. Where HMRC does not receive the tax due, the government proposes that the liability should initially rest with the party that has failed to fulfil its communication obligations, until such a time that it does meet those obligations. This means that liability would move along the labour supply chain as each party fulfils its communication obligations.

If HMRC were unable to collect the outstanding liability from that party, for example, because it ceased to exist, the government proposes that the liability should transfer back to the first party or agency in the chain and, if HMRC could not collect from the first party or agency, the liability would ultimately rest with the client. The government considers that the advantages of this approach are that it would provide a clear incentive for all parties to comply with their obligations and to ensure a determination is passed fully down the chain as well as encouraging all parties to contract with reputable and compliant firms.

## Challenging an employment status determination

In addition to the right to receive an employment status determination and the reasons for the determination as set out above, the government concedes that it will be necessary for a process to be put in place to allow for determinations to be challenged by the worker and/or the fee-payer. The government believes that the most effective approach would be for clients to develop and implement a process to resolve disagreements based on a set of requirements set out in legislation.

The government considers that the introduction of a client-led status disagreement process would allow organisations to tailor the process to fit in with their wider business processes, while maintaining a level of consistency across all organisations. As a minimum the government would expect any process to include the consideration of evidence put forward by the worker and/or fee-payer, advising the party of the outcome of that consideration and the reasons for that outcome. The intention being that this stage will provide additional assurance to workers and fee-payers that the client has not taken an arbitrary approach to determining status and has considered any evidence they may have to the contrary.

## Education and support provided by HMRC

HMRC launched the Check Employment Status for Tax (CEST) service in 2017. It is designed to help clients decide the employment status of their off-payroll workers and to check whether the off-payroll working rules apply.

The consultation states that CEST has been rigorously tested and is able to determine employment status in 85% of cases. However, HMRC continues to work with stakeholders to identify improvements to CEST and to its wider guidance to ensure that it meets the needs of the private sector. Enhancements will be tested with stakeholders before the reform is implemented.

HMRC is currently addressing concerns about CEST's ability to take account of existing employment status for tax case law (with the resulting possibility that it does not give an accurate employment status determination in some cases) and its ability to reflect the complex nature of the private sector (including different types of business model).

The consultation confirms that HMRC is looking to enhance the service to help customers make employment status decisions; to improve CEST guidance so organisations can confidently make employment status determinations that people working through intermediaries will be able to see and understand; and to develop an education and support package for those affected to help them prepare for, and implement changes to the off-payroll working rules.

## What businesses should be doing now

The consultation recommends that organisations affected by the reform should take the following actions now to prepare for the reform:

- ▶ identify and review their current engagements with intermediaries, including Personal Services Companies and agencies that supply labour to them;
- ▶ review current arrangements for the use of contingent labour, particularly within the organisation functions that are more likely to engage off-payroll workers;
- ▶ put in place comprehensive, joined-up processes (assess roles from a procurement, HR, tax and line management perspective) to get consistent decisions about the employment status of the people they engage; and
- ▶ review internal systems, such as payroll software, process maps, HR and onboarding policies to see if they need to make any changes.

In addition to the above we would recommend:

- ▶ putting in place training on employment status for those individuals who will be responsible for determining employment status;
- ▶ engaging with off-payroll workers so that they understand the changes; and
- ▶ reviewing contractual terms to ensure, where necessary, employment taxes may be withheld as well as reviewing supply chain contracts to understand whether any additional employment taxes can be passed onto other parties in the supply chain.

## Who to contact for help

### MICHAEL HUNTER

Partner

+44 (0)161 934 6290  
07841 889190



### JONATHAN FLETCHER ROGERS

Partner

+44 (0)161 934 6347  
07753 428334



### CATHERINE CONCANNON

Managing Associate

+44 (0)161 934 6347  
07590 231963



### NICKY GRIFFIN

Principal Knowledge Lawyer

+44 (0)20 7880 5777



APRIL UTD - IR35 ARTICLE (002).DOCX [10-29737201-1]

aglaw.com

Aberdeen, Doha, Dubai, Edinburgh, Glasgow, Hong Kong, Leeds, London, Manchester, Muscat, Singapore and Tokyo\*

\*a formal alliance with Hashidate Law Office