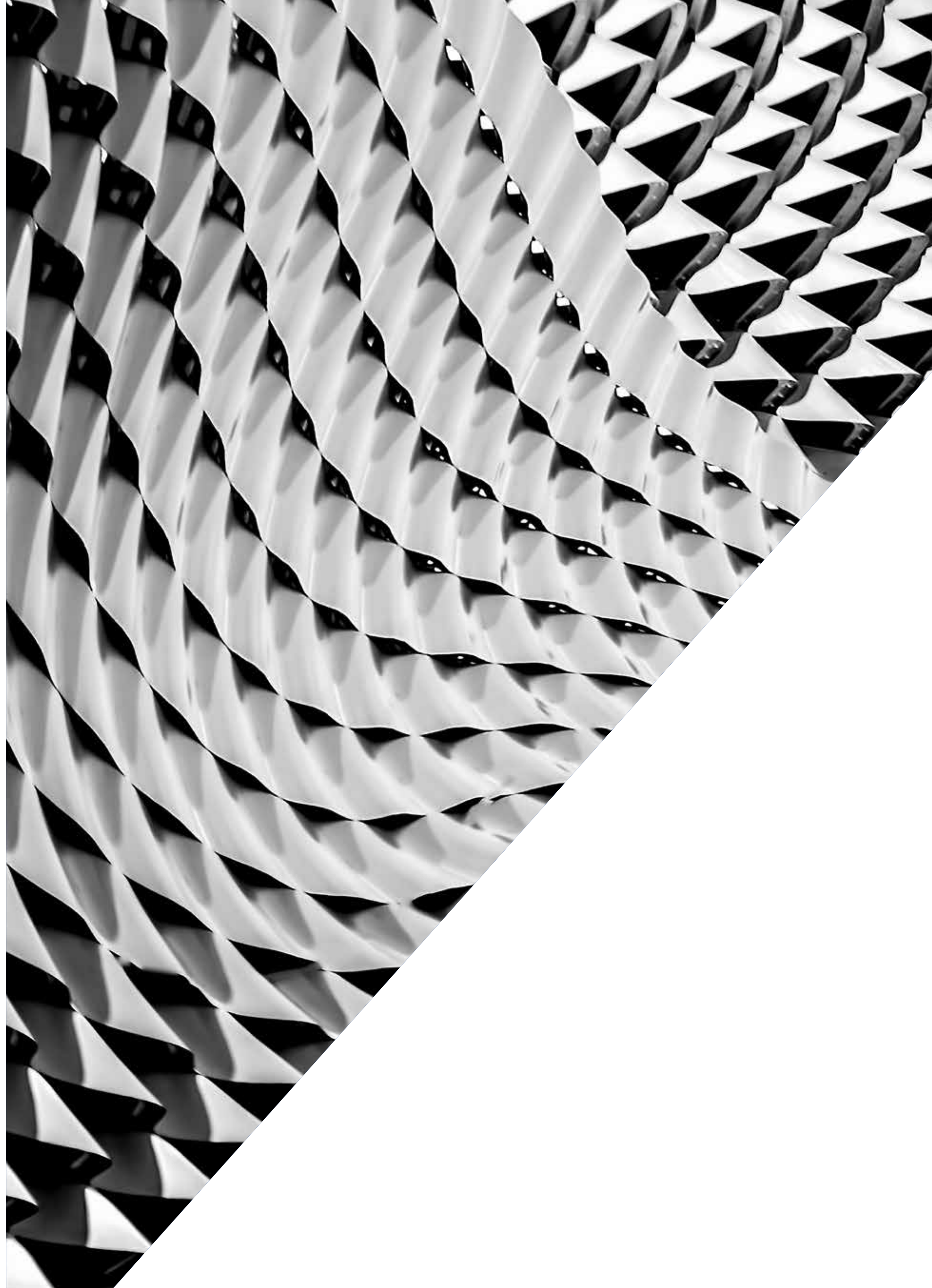


Off-Payroll Working Rules

FAQS

March 2021



Off-Payroll Working rules

From 6 April 2021, if you engage with contractors in your business, then the rules around Off-Payroll Working (commonly known as IR35) will create new obligations, potential liabilities and increased risk for your organisation. Understanding and managing these risks and obligations is more than just another compliance burden. The rules will impact how you procure, pay and engage with the independent services (of a specific contractor) your business requires.

Our recent webinar with ClarksLegal on the changes and how they will affect businesses is available to watch on demand [here](#). Password: Y0vFA=g+

We also know that getting to grips with the changes is not straightforward. Our FAQs tackle some of the questions businesses are asking us.

If you need further advice, please contact us.



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IR35: FAQs

General

When does the rule change come into effect?

It applies to all payments made to contractors on or after 6 April 2021 for services they have supplied personally on or after that date. If the services are provided before 6 April 2021 but payment is made afterwards, the payment is not affected by the new rules.

What is the purpose behind IR35 and the Off-Payroll Working Rules?

HMRC is trying to clamp down on what it regards as tax avoidance. Owner-directors of limited companies enjoy various tax advantages over employees (such as paying themselves minimum salaries and the rest as dividends on profits). The government wants to ensure that people who are really working like employees but through their own Personal Service Company (PSC) broadly pay the same tax and national insurance contributions (NICs) as people who are employed directly.

Under the current system the contractor's own PSC

is responsible for deciding the deemed employment status of the contractor it hires out to its business clients. If the contractor would be regarded as an employee if engaged directly by the client rather than engaged through their PSC, the IR35 rules say the contractor should be taxed as an employee. The contractor will be 'inside IR35', which means they will have to pay tax and NICs on a par with employees.

The owner-director of the PSC currently making the decision about the contractor's deemed employment status, and the contract themselves are one and the same person.

It is usually therefore in the best interests of this individual to deem the working relationship with the client as not being akin to an employment relationship. That puts the contractor outside of the IR35 rules, allowing them to retain the tax advantages of the genuinely self-employed contractor.

Under the current system there are also advantages to the client in agreeing with the contractor's assessment that they are not a 'disguised employee'. For example, the business saves the 13.8% on the Class 1 NICs it pays on an employee's salary and potentially on other employment related costs too.

Does HMRC believe that contractors and the businesses which engage them are 'manipulating' the current system?

In many cases, yes. HMRC has estimated that there is around 80% non-compliance with the IR35 rules in the private sector. That is why HMRC is now shifting responsibility for determining employment status to end user medium and large businesses. Since IR35 came into effect in the public sector in 2017 HMRC has collected millions more in tax and NICs.

Does an end user business client have to issue a contract to every contractor?

If 'every contractor' means every individual, then the answer is no, not strictly speaking. This is because there will presumably be a contract in place between the end user business client and the contractor's Personal Service Company. However, we strongly advise that there are sufficient mechanisms in place within that main contract to create a contractual relationship between the end user business client and the individual contractor. If the business client doesn't have these mechanisms in place it could be left without a remedy against the individual's breach of contract or negligence.

Do the rules only apply to Companies or do they apply equally to LLPs and Partnerships that meet the size criteria?

The guidance states limited liability partnerships, overseas companies and unregistered companies are classed as 'relevant undertakings' in the legislation. The rules for corporate entities apply equally to entities classed as relevant undertakings.

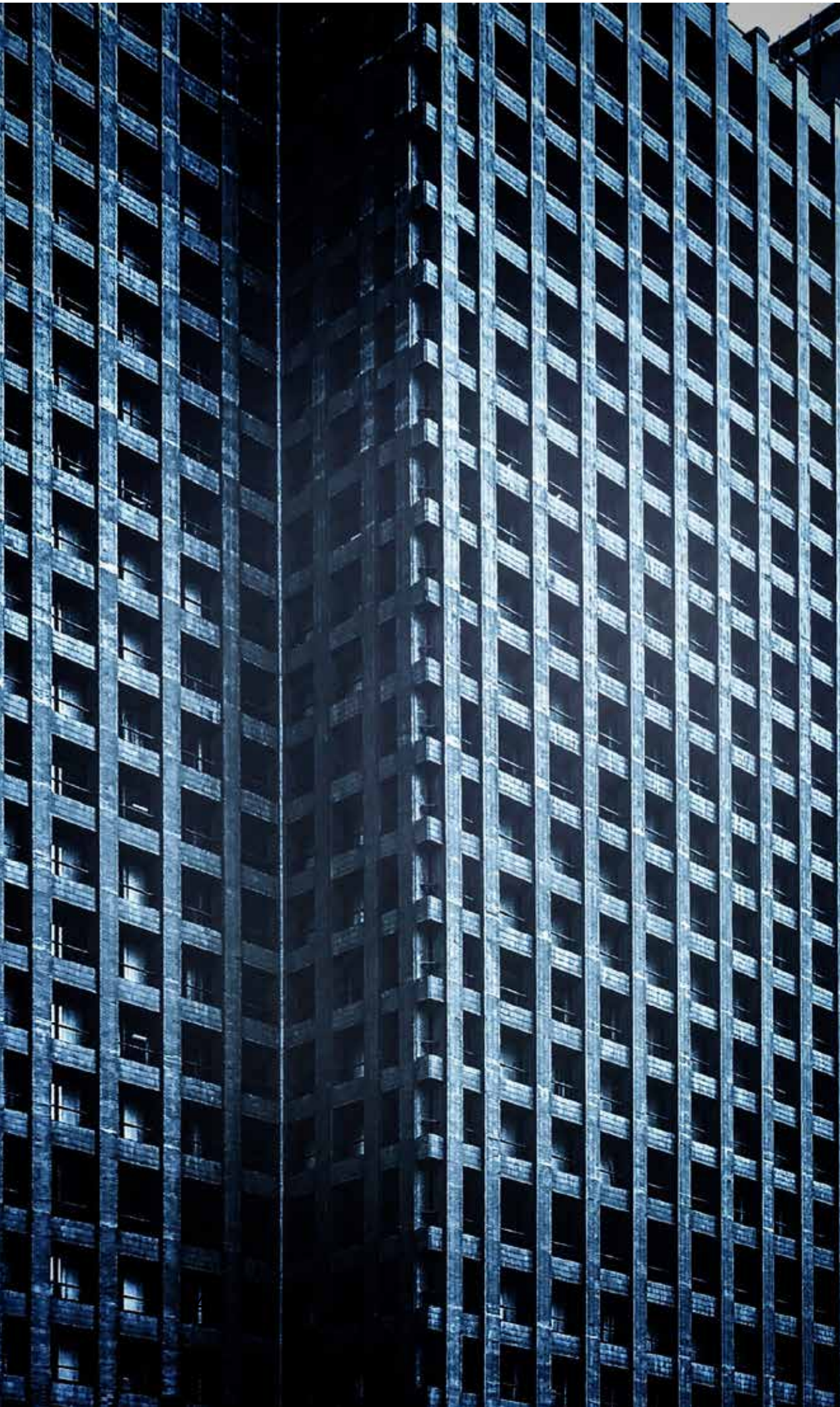
Company size

What is the definition of a medium or large business?

HMRC applies the Companies Act 2006 definition of a medium or large company as breaching two of the following three tests below:

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

Groups of companies are combined for the above test.



What happens when a business's turnover increases and it becomes a medium/large company during the financial year?

Where a company crosses the size thresholds it must meet two of the tests for two consecutive accounting years. The new Off Payroll Working Rules will apply from the start of the tax year following the filing deadline for the company's accounts for the second consecutive accounting year that the size criteria are met.

Status determination

How do I determine a contractor's employment status?

The place to start is by answering the questions on HMRC's online CEST tool. CEST stands for 'Check Employment Status for Tax' and it was introduced in 2017 to help employers, workers and hirers determine if a worker on a specific engagement, should be classed as employed or self-employed for tax purposes.

CEST was updated in December 2020 so if you ran the test before then you may want to run it again.

Is the HMRC tool good enough to be used as a Status Determination Statement

HMRC has provided CEST as a tool to assist the parties and in the large majority of cases the answer is yes, CEST will be good enough. HMRC updated CEST in December 2020 with the aim of making it more effective and reliable. If you want to rely on the outcome from CEST you can save a copy of the questions and answers produced during the online test and this will qualify as a valid Status Determination Statement. You can then give a copy of this to your contractor's PSC and/or any other intermediary in the chain of engagement.

Can businesses rely on the CEST employment status determination?

Yes. HMRC has stated that it will stand by its CEST determination unless it is found to be inaccurate or the results have been achieved through contrived arrangements designed to get a particular outcome. This would be treated as deliberate non-compliance which could attract penalties.

What if CEST deems the individual an employee but they want to remain a contractor?

If the relationship is determined to be one of employment, fundamental changes to the relationship would be needed if that status was to become one of a contractor. It is necessary to look at the whole relationship and how it operates.

As an example, a company would need to give up control of the individual, pay them differently, allow them more autonomy around the work that they do. Changing the wording of the contract is not sufficient because it is what is actually happening that is the driver.

For example, a company might include substitution clauses in a contract but in reality, will that company ever accept a substitute? If the reality is that the substitution would not be accepted then this is what any assessment would be based on, not the contract wording.

Is it permissible to reject a substitute if they do not have the required skills and experience?

It would be wholly reasonable for an end user business client to require any substitute provided by the PSC to have the skills needed to do the job. A conditional substitution clause that is carefully drafted should therefore not cause any difficulties. In cases in which the business client has retained absolute control over whether to accept or reject the substitute, the courts have found an employment relationship.

What impact do restrictive covenants in a consultancy agreement have on determining employment status?

Generally speaking, restrictive covenants should be avoided as they can be a red-light indicator of an employment relationship. However, some limited restrictions on the contractor not to act in conflict with the interests of its business client during the engagement will usually be reasonable. Whether a restriction on supplying services to a competitor will tip the relationship over into one of employment would need to be assessed on a case-by-case basis and would partly depend on the strength and weakness of all the other indicators of employment present in the relationship.

Is it necessary to complete a Status Determination Statement (SDS) for every contractor we use, for example a window cleaner on a monthly basis?

If you are a large or medium sized company and you engage for any services via a PSC, then you will need to follow the determination process even for short/low value engagements.

If a contractor is registered on the company payroll, are separate declarations to HMRC required each month?

If all payments to the contractor go through the payroll and are subject to PAYE tax and NICs, then no further reporting is needed. However, the Off Payroll Working obligations (SDS etc) still need to be carried out.

Is there any suggestion of IR35 regulations impacting contractors provided through a PLC in the future?

It is unlikely that a PLC would be considered as a PSC for a contractor so there has been no commentary on this matter.

If there is absolutely no possibility for the contractor to retain intellectual property - for example in a report they have written - will this impact their employment status?

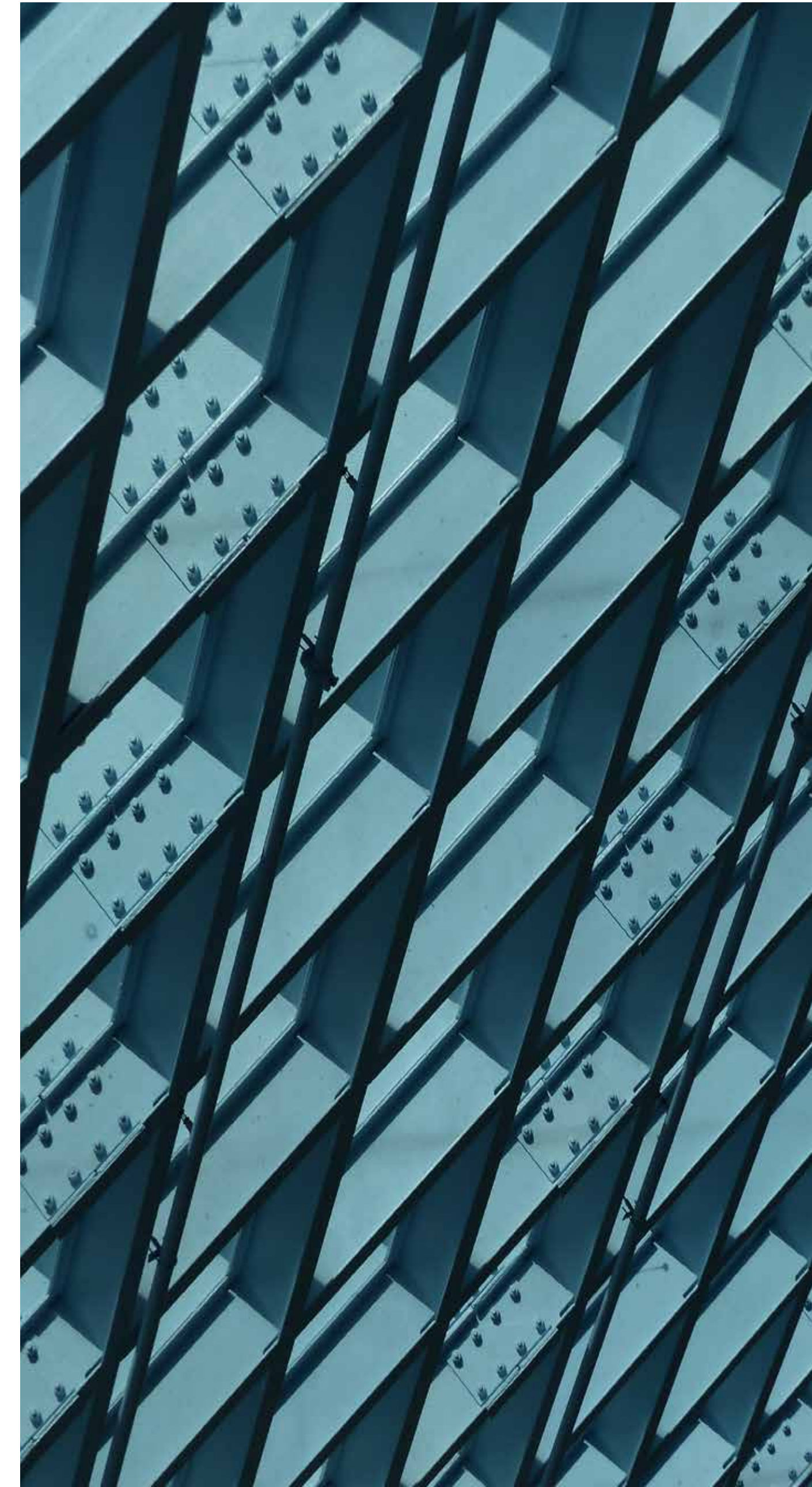
No, not necessarily. Intellectual property is just one of several indicators which HMRC would take into account when deciding employment status. Many end user business clients using contractors to provide professional or creative services will want ownership of the intellectual property produced during the engagement of the services.

The dispute process

What should an end user do if a contractor challenges the SDS?

The end user business client must respond within 45 days of the objection either:

- Confirming its original determination and giving its reasons for so doing; or
- Reversing its original decision, giving the date from which the new status determination applies and confirming that its previous SDS is withdrawn.



IR35: FAQs

Intermediaries

If an intermediary is used, can the end user rely on the intermediary who is paying the consultant to be responsible for PAYE withholdings etc?

Provided the end user has fulfilled their obligations (ie to assess the engagement and pass on the determination to the first intermediary in the chain) the end user has complied with the rules. If there is more than one intermediary in the chain the liability follows the SDS until it reaches the fee payer.

It is important to make sure the contracts with the intermediaries have suitable clauses to protect the end user, clearly setting out responsibilities. Technically, the end user should not have any liability when the SDS has been passed to the intermediary, however this is untested.

What does an agency/Intermediate need to know?

Potentially the most challenging issue for intermediaries will be supply chain management.

Most end user clients will likely introduce contractual requirements that the agency must notify it if a PSC is in the chain of engagement. Effectively, agencies and intermediaries will be responsible for understanding the engagement chain. Ensuring suitable terms and protections are in place is going to be key.

How can the end user check that the information provided by the intermediary is true and accurate? Who is liable if the claim is then found to be false?

Most of the information needed to make a SDS will be within the organisation. A good place to start would be with the department or line manager who works with the contractor so information is gathered about how that relationship is working in practice. The responsibility and therefore the liability for the SDS will fall on the end user from 6 April 2021. However, HMRC has confirmed that it will not impose inaccuracy penalties in the first year unless there is deliberate non-compliance. It has also reiterated its pledge not to use information under the Off-Payroll Working Rules to open IR35 investigations for earlier years.

Charities

When assessing the turnover of charities to determine their size, what income can be disallowed?

When assessing turnover for the purposes of determining company size, grants and donations are excluded.

If a charity uses consultants for grant and donation projects is an SDS required?

If the medium/large company requirements are met and contractors are engaged via a PSC, an SDS will be required.

Insurance brokers

Does IR35 apply to insurance brokers whose turnover falls into the small companies bracket?

The definition of an insurance company is provided in the Companies Act 2006 (CA) and relates to companies that write insurance and carry the associated risk.

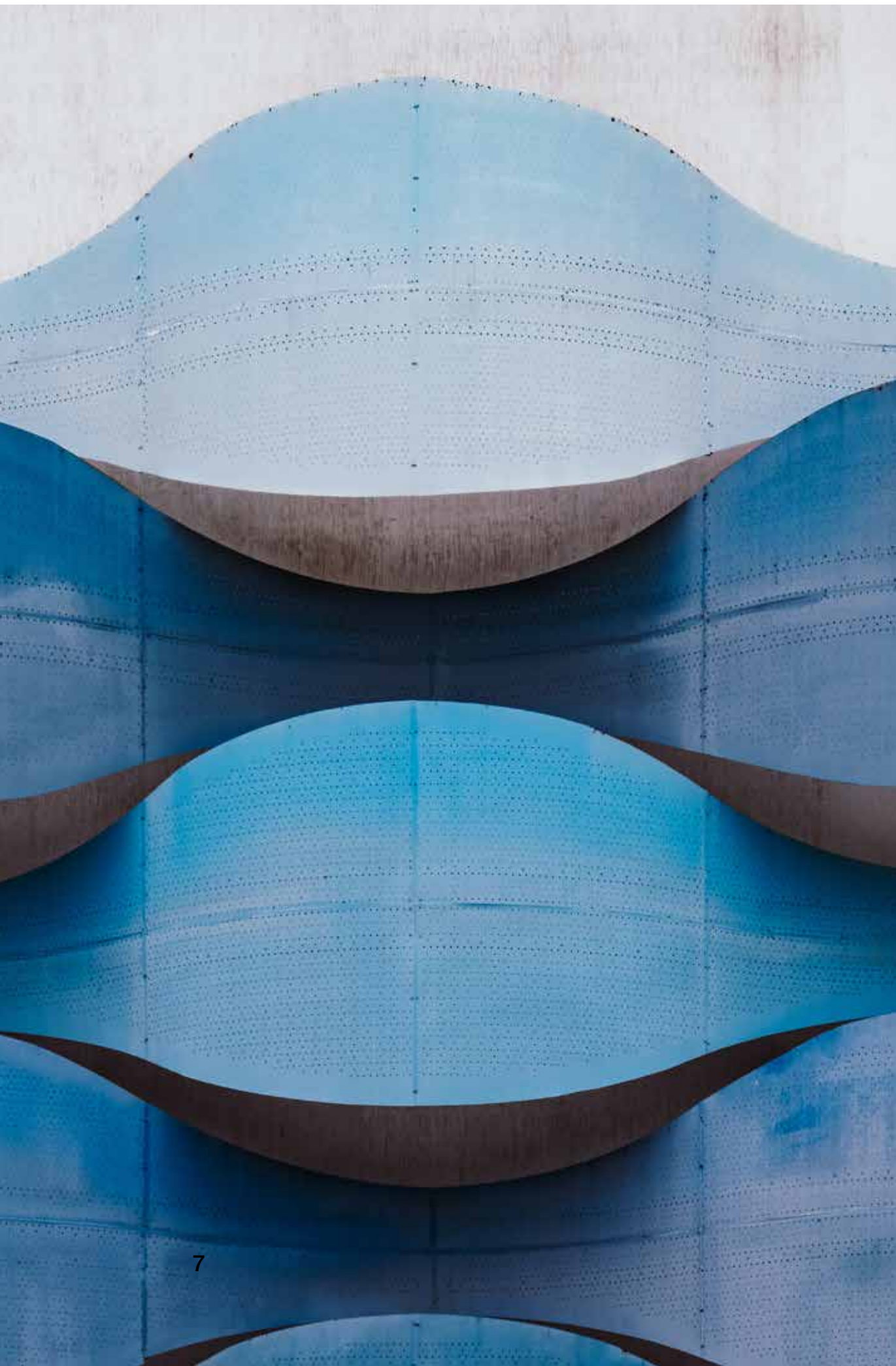
If you are a broker and not required to complete an annual audit (per the CA) due to being a small company then exemption from the new IR35 rules should apply,

However, if the insurance broker meets the criteria for being a medium or large company, then the IR35 rules will apply.

Other business relationships

Will HMRC will be more likely to look into companies where sole traders are being used bearing in mind that they fall outside of IR35?

The existing rules require a company to assess the employment status of sole traders and any obligations for accounting for PAYE and NIC sit with the company.



Other business relationships cont.

What would the implications be of limiting a contractor's work for third parties to those businesses that are not direct competitors?

Any attempt at controlling the outside activities of an individual can point towards an employment relationship. However, it is common practice in many sectors that the end user business client will only engage the contractor if they agree not to work for a direct competitor during the course of the engagement. This reflects commercial reality and the contractor is free to reject the contract, walk away and work for the competitor, or a range of competitors, instead.

Businesses should therefore be at relatively little risk of imposing such a restriction though it would be wise to ensure that all the other genuine indicators of self-employment (such as financial risk) are robust. Businesses should certainly avoid imposing any sort of restraints of trade on contractors after the engagement ends as these are red light indicators of an employment relationship.

Is there any difference between a freelancer and a PSC?

A freelancer is not a legal term but simply a label that is often given to individuals, especially those in creative industries, who work for themselves.

A PSC is a legal entity, owned and controlled by that individual freelancer.

If a professional service is provided via a PSC with E&O cover, does this indicate that the service is not an employment?

Yes, that is right. If the PSC provides its own professional indemnity insurance (usually a considerable financial burden) that is an extremely helpful indicator pointing away from an employment relationship.

What needs to be considered for vendor/supplier agreements from an IR35 perspective?

The Commercial Agents Regulations may apply. The Commercial Agents Regulations apply to all self-employed intermediaries with continuing authority to negotiate or conclude the sale or purchase of goods on behalf of another.

International

Does IR35 apply to non-UK/EU companies who make use of UK/EU off-payroll consultants/contractors?

The contractor has to be liable for UK tax or NIC for these rules to apply.

The rules apply to UK companies, or companies who are engaging with UK individuals. For example, if a UK company engages with somebody who is based in Serbia who works from home, in Serbia, providing consultancy services remotely and has never set foot in the UK, there is no payroll obligation. If, however, the individual physically sets foot in the UK and provides their services, then the end user needs to make an IR35 assessment because the individual has triggered UK tax exposure.

The same rules apply for overseas companies who are engaging with UK workers. If a UK tax presence is created, IR35 rules must be considered. Liability to Tax is based on the individual's residence and if the overseas company has an associated UK company, then host country rules apply and any Pay As You Earn liability falls to the UK company.

VAT

What about VAT?

If payments are deemed to be to an employee and are subject to PAYE/NIC, the service is not subject to VAT.

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