It's not just about status

Employment Tax



01 January 2020

Kate Upcraft considers the complexities involved in off-payroll working

Key Points

What is the issue?

Operational questions relating to off-payroll working remain unanswered in respect to the withholding of tax and NI by the fee payer, as well as how to handle the payroll for the personal service company (PSC) when the director wants to withdraw salary.

What does it mean to me?

An inside IR35 ruling applies where the engager has decided that the new legislation applies; i.e. if you stripped away the intermediary limited company or partnership, the engager has taken the view that the engagement has the hallmarks of employment.

What can I take away?

Withholding has to commence immediately once an inside IR35 Status Determination Statement (SDS) is issued, even if the consultant appeals the ruling.

Off-payroll working has been with us in the public sector since April 2017. Yet surprisingly, after two and a half years there are still operational questions that remain unanswered, in respect to the withholding of tax and National Insurance (NI) by the fee payer, as well as how to handle the payroll for the personal service company (PSC) when the director wants to withdraw salary.

In this article, we'll focus on the operational angle to the reforms, exploring the things we know as well as the 'known unknowns'!

Business process

The first thing to say is that this move to include a new type of payee within a fee payer's payroll does not require any major software change to payroll systems. In fact, there is just one small change to real time information (RTI) from next April to support off-payroll working, which was requested by the ICAEW and supported by the student loan policy team in HMRC – more of that later.

There is no need for new functionality within payroll software, as all payroll software can withhold the correct amount of tax and NI! The challenge lies with managing the business processes to ensure that however the fee payer's payroll is run, the appropriate information is received at the right time to facilitate the operation of PAYE and NI and the onward reporting of that withholding.

Which payroll?

An inside IR35 ruling applies where the engager has decided that the new legislation applies; i.e. if you stripped away the intermediary limited company or partnership, the engager has taken the view that the engagement has the hallmarks of employment. It is useful at this point to clarify who the fee payer is, and therefore who will be doing the withholding. There are various scenarios:

- The director of the PSC (who we'll refer to as 'the consultant') is no longer operating through their limited company, insomuch that the fees from any engagements caught by IR35 are now processed via an umbrella PAYE scheme. This is run by an agency that will charge an admin fee for doing this work to either the engager or the consultant, as well as the employer's NIC (as this won't be borne by the umbrella operator).
- The engager sources its consultants through an agency, or agencies, which pay the consultants' invoices before charging the engager. Historically, such agencies would perhaps only have been charging an admin fee for procuring the consultant and handling payments. However, for inside IR35 rulings the final agency in the chain will now add the consultant to a PAYE scheme to withhold tax, Class 1 NIC (both primary and secondary) and apprenticeship levy (if applicable). The employer's NIC and levy will be charged back to the engager in addition to the current admin fee.
- The engager runs its payroll in-house and sources consultants directly without an agency. For inside IR35 rulings, these deemed employees must be added to their payroll for withholding to take place and for RTI reporting purposes. The employer's NIC and apprenticeship levy for consultants are simply part of the total liabilities of the PAYE scheme and will display as such on their Business Tax Account.
- The engager has outsourced their payroll, so for their direct consultant engagements they will have to ask their payroll agent to add them to the payroll for withholding and reporting purposes. The liabilities for the consultants

are part of the amounts notified to the engager by the payroll agent.

What is the salary?

The consultant's fees from their invoice become the earnings which will be submitted in the Full Payment Submission (FPS) and subjected to tax, Class 1 NIC and the apprenticeship levy. The VAT and any allowable expenses on the invoice will still need to be paid gross to the PSC. Any 'allowable expenses' refers to the fact that only those expenses that would be tax relieved for an employee will be tax relieved for a deemed employee. This will therefore exclude the tax-free payment of normal commuting costs to a permanent workplace, but would include, for example, expenses related to a training course that the consultant had been sent on by the engager.

PSC director to deemed employee

We are clear from the clauses that were in the Finance Act, before it fell away when parliament was dissolved, that withholding has to commence immediately once an inside IR35 Status Determination Statement (SDS) has been issued, even if the consultant appeals the ruling. If the appeal is upheld, then the payroll has to be reversed to remove the deemed employee from the payroll and recover the tax and Class 1 NIC that has been withheld incorrectly.

RTI reporting is geared to individual taxpayers, not corporate entities. The only time the system can be used to report a non-individual is where a corporate trustee is receiving a pension payment. We therefore have the challenge of turning the PSC into a 'deemed employee'. The classification of 'deemed employee' is used because the only reason they are within RTI is to deduct and report the tax and NI; they have no employment rights as an actual employee would, for example to be auto-enrolled into a workplace pension or to any statutory payments. It is for their PSC to continue to provide these.

Setting up the payroll record

In order to be able to set up a payroll record, the fee payer needs the following personal information about the director of the PSC:

- forename and surname;

- date of birth;
- gender; and
- national insurance number or two lines of their address (the address must be their residential address, not a business address, in order for HRMC to be able to assess correctly whether they have Scottish or Welsh tax residence and to be able to issue the appropriate tax regime identifier with their tax code).

It therefore makes sense for the fee payer to create a deemed employee 'starter checklist' so this information can be captured as soon as an inside IR35 ruling is determined. As the fee payer will now be working to payroll deadlines rather than accounts payable deadlines, this has to be factored into discussions on business process changes as it will impact payment terms and conditions in respect to contracts. It may be that additional, more regular, payroll runs have to be introduced for consultants, with the additional associated costs. We are clear that the NIC table letter assigned to the consultant must follow the normal age driven rules:

- under 21: table letter M;
- 21 to state pension age: table letter A; and
- over state pension age: table letter C.

It would be possible for a consultant to apply for deferral but that would be a personal matter for them, as it is for any taxpayer.

What is less clear is the appropriate tax code to allocate. Since 2017, the public sector has been told to allocate tax code BR and starter declaration C, on the basis that the consultant already has a primary employment with their PSC where their personal allowance is allocated. Representations have been made to HMRC that it would be more appropriate for tax code 0T/1 to be used, as it is unlikely that the consultant will ultimately be liable only to 20% tax on this source of income.

There is then the matter of the start date to attach to the consultant's record. There will be many consultants who have been undertaking contracts prior to 6 April 2020 with the same engager, so should we use the start date when the contract first commenced? This could be uncomfortable for the consultant, as they may feel that a retrospective start date would trigger a retrospective status enquiry.

We were encouraged by HMRC's statement on 22 October in their issues briefing: 'HMRC have taken the decision that they will only use information resulting from these changes to open a new enquiry into earlier years if there is reason to suspect

fraud or criminal behaviour.’

However, there can be no cast iron guarantees, and in any event it is impossible to insert a start date that is more than seven years earlier than the start of the current tax year. We have therefore agreed with HMRC to use a start date of 6 April 2020 on the records of any deemed employees where there has been an ongoing engagement, or the start date of the contract in all other circumstances post-6 April 2020.

Finally, the ‘off payroll worker’ (OPW) marker, to be newly introduced from April 2020, must be set (it isn’t clear why it isn’t called the ‘deemed employee marker’!). We have lobbied for HMRC to introduce this in order for them to be able to inhibit the production of student loan start and stop notices. The collection of student loans remains with the consultant when they complete their self-assessment return.

It is sensible for fee payers to ask their payroll software provider if the OPW marker will be used within their own payroll/HR systems to suppress functionality related to auto-enrolment, statutory payments and reporting that should be restricted to actual headcount, such as gender pay gap statistics. It is important to note that if the OPW marker is inadvertently set against an actual employee’s record, even if it is removed by the fee payer in the next payroll run, it cannot be removed from their record by HMRC as is it is attached to this particular income source. The only solution would be for the affected employee to be resigned and for the employer to re-engage them.

The end of the contract

When the consultant’s contract is complete, a P45 should be provided; and if they are still on the payroll at the end of the tax year they should be given a P60. Within their personal tax account, the income from the engager will be shown with the tax and NI that has been paid.

Any salary or dividends withdrawn from the PSC will be tax and NI free up to the level of income that has already been taxed by the fee payer. Salary payments should be reported tax and NI free through RTI as normal. Any salary in excess of that which has already been subject to withholding should be treated as subject to tax and NI as normal.