Change is the only constant

Employment Tax



06 May 2021

In the first of two articles, Edmund Paul and Jonathan Berger explore some of the key employment tax changes that came into effect from 6 April 2021, starting with the off-payroll working changes and the Construction Industry Scheme

Key Points

What is the issue?

The 2021/22 tax year will see the introduction of several significant employment tax legislative changes.

What does it mean for me?

Taken together, the changes will significantly increase the complexity, costs and challenges for businesses.

What can I take away?

Preparation is key in ensuring that businesses can comply with the new rules.

Employment taxes have been an area of significant focus for the government with the 2021/22 tax year seeing several significant pieces of legislation being introduced. For many, changes to the off-payroll working rules have stolen the headlines but other changes have added further cost and complexity, including amendments to the Construction Industry Scheme. The second part of this article will consider the representative occupier rules for accommodation, as well as the cessation of grandfathering provisions for certain employer provided benefits caught by the optional remuneration arrangement legislation.

Off-payroll working changes

Prior to 6 April 2021, where a business in the private sector engaged a worker through an intermediary (typically referred to as a personal services company) and the arrangements were suitably robust, the intermediary remained responsible for determining the employment status of the worker and operating PAYE and NIC, if required.

However, the ‘IR35’ rules changed with effect from 6 April 2021 for medium and large employers, whereby the responsibility for determining employment status and withholding PAYE shifted up the contractual chain. The ‘end client’ is responsible for determining the employment status of the worker. This brings further obligations which are also extended to public bodies.

These include preparing a status determination statement and passing it down the contractual chain, as well as establishing a suitable dispute resolution process. The ‘fee payer’, being the entity that contracts with the intermediary, is responsible for deducting PAYE and NIC due where the worker is deemed employed.

For a status determination statement to be valid, the end client must take and be able to evidence ‘reasonable care’ when preparing it. Whilst there is limited guidance on what constitutes reasonable care, HMRC has indicated in its guidance that reasonable care will be viewed ‘in light of the abilities, experience and circumstances’ of the business.

Finally, there are transfer of liability provisions which potentially enable any underpaid income tax or NIC to transfer to the first agency in the contractual chain and, if not collected from this entity, then to the end client itself.

Key considerations for the 2021/22 tax year

Client led status disagreement process Whilst end clients may have pre-empted disputes by providing a status determination statement ahead of the 2021/22 tax year and agreeing the worker’s employment status, workers and deemed employers are entitled to formally dispute an employment status assessment by providing representations as to why the original assessment was incorrect.

The dispute can be raised any time during the engagement and prior to the final payment in relation to the engagement. End clients are required to respond to these representations within 45 calendar days of receipt, either informing the worker that the original status determination statement is correct (with supporting reasons) or providing an updated statement. If a response is not provided within the legislative timeframe, the PAYE liability transfers to the end client.

Worker disputes can be time consuming and may require several rounds of correspondence before they are resolved. Where differing assessment methods have been utilised by both parties generating different results, these disputes can

be particularly difficult to amicably resolve and can bring further disruption.

Supply chain due diligence

Many businesses, particularly in the financial services industry, have sought to short circuit the legislative changes by requiring all contractors to be on a payroll (either via an umbrella company or an agency), meaning that a status determination statement and associated processes are not required.

However, liability may still arise where entities further downstream do not correctly withhold PAYE. This risk is heightened where there are overseas entities within the contractual chain, or where the business has not undertaken appropriate due diligence. Businesses should therefore ensure that they have appropriate contractual provisions in place to cover such risks and adequately review the full labour supply chain. HMRC has the ability to transfer liability up the supply chain in order to pass obligations onto the end user in certain circumstances of non-compliance.

HMRC compliance approach

HMRC confirmed in its compliance strategy that businesses would not suffer penalties for inaccurate determinations in the first 12 months unless deliberate non-compliance with the rules can be evidenced.

However, where an incorrect self-employed assessment has been made, end clients remain liable for underpaid income tax and NIC. Furthermore, HMRC will need to validate that the errors have been corrected and processes updated accordingly, which could include HMRC auditing all information relating to the off-payroll working population, as well as ‘naming and shaming’.

After a delayed start in the private sector, IR35 is here to stay. Businesses need to ensure awareness and potentially upskill themselves to deal with the requirements.

> From 6 April 2021, for medium and large employers, responsibility for determining employment status shifted up the contractual chain.

Construction Industry Scheme

Whilst the new VAT reverse charge rules for the construction industry were introduced from 1 March 2021 (and were the subject of an article by Neil Warren in February 2021's edition of Tax Adviser), Finance Bill 2021 also introduced several changes to the operation of the Construction Industry Scheme.

Most significantly, it changed the threshold required for a business to be considered a 'deemed' contractor and restricted the ability of subcontractors to claim deductions for material costs incurred. It is worth noting the interaction between the off-payroll working rules (IR35) and the Construction Industry Scheme. If the subcontractor falls within IR35, this removes the requirement to operate the Construction Industry Scheme (as the subcontractor will be considered a 'deemed employee' for tax purposes).

Deemed contractor changes

Under the Construction Industry Scheme, some businesses and public bodies outside the mainstream construction industry that regularly carry out or commission construction work are brought within the scheme and deemed to be contractors.

Historically, this condition was met where the annual expenditure on construction for these businesses exceeded £1 million on average over three periods of account. The business would then begin operating the Construction Industry Scheme from the start of the next period of account.

However, since 6 April 2021, a business is a deemed contractor and must register for the Construction Industry Scheme where the cumulative expenditure on construction operations over a rolling 12 month period exceeds £3 million. HMRC has included transitional rules, so that where a deemed contractor is currently caught by the rules, they will remain within the scope of the scheme until they are not expected to incur further expenditure on construction operations.

The legislation allows for only a limited grace period, allowing businesses that inadvertently or unexpectedly breach the deemed contractor threshold time to set up processes enabling them to operate the Construction Industry Scheme rules effectively.

Businesses will need to develop processes to monitor their expenditure on construction operations to ensure that the threshold is not breached over a rolling 12 month period; however, the legislation does not prescribe the frequency of such checks. As such, businesses may need to undertake very regular, possibly daily,

checks requiring significant business resource. In addition, suitable record retention is needed to validate and evidence expenditure.

False documentation penalties

HMRC has the right to impose a potential subcontractor penalty of up to £3,000 where false documentation is used in support of gross payment status or reduced withholding. The legislation has been expanded to apply to the individuals or companies who can exercise influence or control over a person making the application.

Material deductions

The government has amended the Construction Industry Scheme legislation so that only the cost of materials purchased directly by a subcontractor is deductible for the purposes of the legislation. The change was introduced as HMRC perceived that, in some cases, multiple entities within the contractual chain could be claiming Construction Industry Scheme offsets for materials they did not directly incur, raising concerns that scheme deductions were being artificially reduced.

Key considerations for the 2021/22 tax year

Cashflow within supply chains

Prior to this, entities within the supply chain frequently reimbursed each other for material costs incurred further downstream until the cost was borne by the client. As such, where subcontractors do not hold gross payment status, the changes will likely result in reduced cashflow.

Commercially, businesses are exploring changes to their engagement terms to avoid negative cashflow implications, including:

- requiring subcontractors to invoice materials separately on delayed payment terms;
- changing the entity responsible for procuring materials; or
- requiring the customer to pay an advance for the procurement of materials.

Exiting the Construction Industry Scheme

Where a deemed contractor is caught by the Construction Industry Scheme, the legislation allows that business to leave the scheme where it is ‘not expected to make any further expenditure on construction operations’ (including retention or management/administration payments) under any construction contract. However, given that the definition of construction operations is broad and can cover minor ongoing works, it may be difficult in practice for a business to do so. As noted above, whilst the legislation makes it difficult to exit the Construction Industry Scheme, HMRC has suggested in its guidance that where a business has spent less than £3 million on construction activities during the prior 12 months, it would accept a request to deregister as a deemed contractor.

These changes bring more complexity to the Construction Industry Scheme and it is important that businesses seek to understand their impact quickly, as well as ensuring they retain suitable documentation and evidence.

In the second part of this article, Edmund Paul and Jonathan Berger consider the cessation of grandfathering provisions for certain employer provided benefits, the withdrawal of the representative occupier concession for employer provided living accommodation and other employment tax changes of note.