Working off-payroll is on the agenda

Employment Tax | Tax voice



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Lesley Fidler provides a canter around the IR35 field

IR35 is the colloquial name for the intermediaries legislation found in *Part 2, Chapter 8 of Income Tax (Earnings and Pensions) Act 2003* and *section 4A Social Security Contributions and Benefits Act 1992*. The term comes from the Budget 1999 press release that introduced the anti-avoidance provisions with effect from 6 April 2000. It is also used for the whole area in which conventional employment arrangements are restructured to take the form, if not the substance, of self-employment.

The original IR35 rules were intended to prevent employees and employers avoiding the operation of PAYE and the cost of employer's and employee's Class 1 NICs costs. Instead of working directly for an employer, the individual would set up a limited company (often referred to as a Single Member Company: "SMC") that contracted with the former employer to provide the individual's services. The work-giving business did not need to operate PAYE or suffer employer's NICs on the business-to-business payments to the SMC. Individuals could extract profits from their SMCs as dividends and/or pay salaries to family members at a level that provided an NICs record but avoided a tax liability.

The same individuals still carried out the same work for the same end-users but were no longer employees.

The intermediaries provisions attempted to prevent such structures being beneficial in tax and NICs terms by requiring the intermediary to account for PAYE and NICs on its payments to its workers if, without the intermediary in the relationship between worker and end-user, the worker would have been an employee of the end user. Unsurprisingly, very few who were benefitting from the use of an intermediary felt that this provision applied to them. Some ignored it entirely; others believed that their particular working relationship was nearer self-employment and so outside its scope. For HMRC to prove that a hypothetical relationship was akin to employment was difficult and time consuming and there are many tax cases on the topic (for example, early cases such as *Lime-IT Limited v Michael Justin* [2003] STC (SCD) 15 and *Dragonfly Consultancy v CRC* [2008] EWHC 2113 (Ch).)

In the situation described earlier, the SMC is the 'intermediary' but there were various other structures. If properly implemented, they all had the advantage of removing employment taxes and employment law protection including payment of the national minimum wage and application of the Working Time Directive.

Initially used by professionals who understood – more or less – what was happening, the concept was packaged and offered (or in some cases imposed) as a way of increasing the earnings of large groups of workers and/or reducing the cost of engaging them (for example, the arrangements described in *Autoclenz v Belcher* [2011] UKSC 41, where the employment law categorisation of a team of car valeters was scrutinised by the Supreme Court, having previously been reviewed for tax purposes).

To try and prevent this, the Managed Service Company (MSC) legislation in *Part 2, Chapter 9 ITEPA 2003* was introduced in 2007. Instead of dealing with the issue at an individual level, it targeted MSC Providers (MSCPs). These are businesses that manage such arrangements, taking their fee out of the savings achieved. Their services would typically include setting up SMCs and handling the payments to and from those SMCs. By including a provision making the directors of MSCPs personally liable for any PAYE and NICs debts of their 'customers', it convinced many MSCs that the financial risks for them were too great. The case of *Christianuyi Ltd & Ors v Revenue and Customs* UKFTT 272 (TC) described in HMRC's Spotlight 32 is a recent example of HMRC's approach and how an MSCP operated.

Adding to the complexity in this area is the fact that temporary work at all skill levels is usually facilitated by agencies. Those agencies have long been expected to operate PAYE on payments to their workers but until 5 April 2014 *section 44 ITEPA 2003* had an exception for workers who were not 'subject to supervision, direction or control as to the manner of the performance of their duties'. It was perceived that this exception was being exploited unjustifiably. Perhaps influenced by the success of the MSCs legislation in tackling the loss of revenue via middlemen, the exception was narrowed considerably by *Finance Act 2014* and now applies where, amongst other criteria, 'it is shown that the manner in which the worker provides the services is not subject to (or to the right of) supervision, direction or control by any person ...'. Displacing a supposition that someone, anyone, has a right to say how a job is done is a very high bar indeed.

Returning to the story of IR35, by 2012 many individuals in the public sector who were in a position to dictate their own terms of appointment were using SMCs instead of being engaged as employees. It is possible, but highly unlikely, that they were voluntarily operating the intermediaries provisions and applying PAYE and Class 1 NICs to all their company receipts. It is probable that they and their 'employers' paid less in tax and NICs. The issue came to a head when it was made public that Ed Lester, the chief executive of the Student Loan Company was engaged via a service company. The ensuing Alexander Review resulted in procurement rules for central government that require departments to obtain assurance that contractors 'off payroll' pay the correct tax and NICs if their engagements last at least six months or pay at least £220/day.

So, entering the home straight with the next set of hurdles, in its Autumn Statements 2016 the Government announced that it would be introducing new legislation in Finance Bill 2017 creating *Chapter 10, Part 2 ITEPA* If enacted, and there seems little doubt that it will be, it will provides that any payments made after 5 April 2017 by the public sector to workers that are not directly employed will be subject to deduction of notional PAYE. (The NICs provisions are similar but separate.) As with the original IR35 provisions, the rules will not apply if the workers would not be employees if directly hired. The public sector is defined as any organisation within the scope of the Freedom of Information Act 2000 and the Freedom of Information (Scotland) Act 2002.

Where there is a chain of agencies (often the case where a business uses a single, generalist, agency but requires, e.g. a VAT specialist, who will have registered with

an agency specialising in tax appointments), it is the agency nearest the worker that will be required to make the judgment as to whether the deductions should be made and to account for them under RTI.

Unlike the original intermediaries rule, there will not be a 5% allowance to cover expenses, although expenses that an employee could claim will not be subject to the tax and NICs deductions. The effect is that contractors with specialist skills who provide a flexible workforce but who have to travel away from home in order to find such work will not get any tax or NICs relief for their home to work travel.

To assist it in determining whether a particular worker is within the scope of the new rules, the agency will be expected to use a new digital tool akin to the Employment Status Indicator (ESI) to determine whether an engagement is fundamentally an employment.

The digital tool is not yet in the public domain and it remains to be seen whether it can cope with the task that is required of it. To boil down decades of tax cases relating to employment status into a rigid set of questions and answers is no mean feat. In addition, it can only reflect the working arrangements as they are known at the time it is completed. An initial forecast of future working arrangements will necessarily be based on assumptions. Operational considerations may change the original expectations. Contractors whose work is initially subject to close scrutiny may be given considerable freedom once they have proved their competence. Conversely, the level of monitoring may increase once issues with a contractor’s work come to light.

An additional concern for the genuinely independent agency worker is that agencies may take a very prudent approach and fail to identify any of their contractors as being outside the scope of the new rules.

Agencies that supply staff to organisations as diverse as NHS Trusts and maintained schools will be affected by the new rules. But if, as many believe, this is effectively a wide-scale pilot of a universal attempt to recoup lost payroll revenues, all agencies and those who supply their services through them are likely to be affected in the future.