

## Reforms to Off-Payroll Working – Extension to the Private Sector

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8 August 2018

**Update October 2018:** The government announced in the 2018 Budget that the extension to the rules described in the rest of this update will take effect from April 2020 and will not apply 'to the smallest 1.5 million businesses'. It is not yet known how the government will define these small businesses and, as the scope of the relief is likely to be very limited, small businesses should be prepared to comply with the new rules rather than rely on any exemption.

### BACKGROUND

HM Revenue & Customs estimate that about one third of individuals working through an intermediary Personal Service Company (PSC) – i.e. off-payroll working – are effectively working in the same capacity as an employee of the PSC's end customer.

Working through an intermediary company rather than being directly employed means that the worker can benefit from a lower overall tax rate. There is additional flexibility due to control over extracting profits either by way of paying dividends or of winding up the company. The PSC's end customer also benefits, as they will not incur a liability to employer's National Insurance contributions (NICs) on payments to the intermediary, representing a saving to the customer at a rate of up to 13.8%.

Anti-avoidance 'IR35' rules, if applied correctly, require an individual who would be classed as an employee were it not for the intermediary company to account for approximately the same amount of income tax and NICs as would be due if they were employed directly. However, HMRC currently estimate that only 10% of individuals to which the rules apply correctly follow these requirements.

In order to tackle tax avoidance in this area, new rules were introduced with effect from 6 April 2017 which applied only to engagements with public sector end clients. On 18 May 2018, HMRC announced a consultation on whether these new rules should be extended to the private sector, or whether a separate set of rules should be introduced. That consultation closed on 10 August 2018.

### OFF-PAYROLL WORKING RULES IN THE PUBLIC SECTOR

The new public sector rules differed from IR35 as they shifted responsibility for determining the hypothetical employment

status of the worker from the intermediary to the public authority. In order to make it easier for the public sector employer to determine the worker's status under the hypothetical contract, a digital service (Check Employment Status for Tax (CEST)) and a helpline were also introduced.

Changes to the rules also transferred responsibility for paying any additional tax and NICs from the worker to the public authority or agency through which the worker was employed. It was felt that the public authority or agency would be better placed to operate PAYE rather than the intermediary company.

The government believes that these changes have been successful and is looking to extend these rules to the private sector, making it the responsibility of the end customer to assess the employment status of the worker.

Many have criticised the new rules, and in particular the CEST tool. The CEST tool assumes that an important indicator of an employer/employee relationship, "mutuality of obligations", is present in all cases. It has been widely reported that public authorities using CEST are concluding that IR35 applies in the majority of cases and are forcing workers onto their payroll.

### SECURING THE LABOUR SUPPLY CHAINS

As an alternative to extending the new rules to the private sector, HMRC is also consulting on encouraging or requiring businesses to ensure that their off-payroll workers are complying with the off-payroll working rules. This would involve customers being encouraged or required to make checks on their labour supply chains, and could include:

- A check of sustainability of the supply chain;
- A check of the history of the labour supply business;
- A compulsory clause in all contracts requiring labour suppliers to show evidence of PAYE returns made to HMRC;
- A compulsory clause in the labour contract requiring authorisation before any aspect of a contract is sub-contracted to a third party labour supplier;
- A compulsory clause in the contract preventing the use of offshore intermediaries;

- A check that workers supplied by agencies who are treated as self-employed are correctly applying the agency rules;
- A check that the agency has complied with the employment intermediary reporting requirements and has evidence of submitted reports to HMRC where they do not operate PAYE; or
- A requirement for customers to check a completed CEST determination from a PSC against their working practices.

Suggested penalties where businesses have not checked compliance with the rules include denying the taxpayer a tax deduction for the cost of any labour, or naming publically those found to have non-compliant labour supply chains.

## CONSEQUENCES

### PSCs

Those operating a PSC in the private sector need to consider whether they might fall within IR35. If so, the PSC will need to ensure that it complies with IR35 rules or the worker will need to alter their working practices (and probably their engagement contracts).

### CUSTOMERS OF PSCs

Extending the rules by either of the above methods will result in a greater administrative burden to entities which engage workers through PSCs. This is also likely to affect businesses who use off-payroll workers to cover staff absences and to meet unexpected demands, or those who use off-payroll workers to remove the costs of operating their own payroll.

## CONCLUSION

It is likely that the rules relating to the use of intermediary companies in the public sector will be extended in some way to the private sector. PSCs – and customers of PSCs – operating in the private sector will need to monitor the progress of the consultation and any subsequent legislation to ensure that they remain compliant with existing and new rules.

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Dixon Wilson  
22 Chancery Lane  
London  
WC2A 1LS

T: +44 (0)20 7680 8100  
F: +44 (0)20 7680 8101  
DX: 51 LDE

[www.dixonwilson.com](http://www.dixonwilson.com)  
[dw@dixonwilson.co.uk](mailto:dw@dixonwilson.co.uk)