

Employment Intermediaries and Personal Service Companies – New UK Tax Proposals for the Private Sector

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As announced at last year’s Autumn Budget, the UK government is considering changes to the off-payroll taxation rules (commonly referred to as IR35) for the private sector.

Although later than expected, the consultation (entitled “*Off-payroll working in the private sector*”) has now been published. A copy can be accessed [here](#). It provides details on proposals for reforming the private sector rules, as well as an update on the impact of the recent public sector reform (which took effect in April 2017). The closing date for comments is 10 August 2018.

In terms of timing of legislative changes, the consultation document gives no indication of when any new rules could come into force. The earliest possible date would be April 2019. Some commentators consider that April 2020 would be a more realistic date, on the basis that draft legislation for inclusion in the next Finance Bill is expected to be published on 6 July 2018 (ahead of the consultation closing date). However, there can be no certainty until timing is confirmed later in the year, and it would therefore be prudent for businesses to plan ahead.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

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Background

IR35 applies to arrangements where an individual provides services through a personal service company (the “PSC”) to a person (the “end user”), in circumstances where, but for the PSC’s involvement, the individual would be considered to be an employee of the end user.

The aim of IR35 is to ensure that broadly the same amount of income tax and National Insurance contributions are paid as would be accounted for through payroll if the individual were employed directly by the end user.

Where IR35 is found to apply to an arrangement, liabilities for income tax and National Insurance contributions are triggered, and these are calculated by reference to the amounts paid to the PSC for the provision of services by the individual.

For arrangements in the public sector, responsibility for compliance with IR35 was recently (with effect from April 2017) shifted from the PSC to the relevant public body (being the end user) or, where payments to the PSC are made through one or more agencies, to the agency closest to the PSC in the payment chain.

In contrast, responsibility for compliance with IR35 with regard to private sector arrangements still lies with the PSC (rather than the end user). Based on a perception of wide-spread non-compliance by private sector businesses, the government is considering either to extend the public sector rules to the private sector or to implement changes with the purpose of encouraging or requiring end user businesses to ensure compliance by their PSC contractors.

The consultation is concerned with compliance only; it does not consider whether any changes should be made to the existing rules on determining employment status. It should be noted, however, that the government recently carried out a separate employment status consultation, which considers the case for aligning the rules on determining employment status for tax and employment rights. While the government has yet to publish responses to that consultation, the expectation is that changes to those rules will also be made.

Has the public sector reform been a success?

When the public sector reform of IR35 took effect in April 2017, initial reports suggested that the reform was causing a significant reduction in the number of consultants engaged by the public sector, as well as increased pressure on the level of consultant fees, and resulting delays for government projects.

HM Revenue & Customs (“HMRC”) have disputed this, based on independent research commissioned by them on the experiences of public authorities in implementing the reform. As reported in the current consultation, such research suggests that public authorities experienced early difficulties in complying with the new rules, but were now largely confident that they were applying the rules correctly. It also suggests that, for most public authorities, neither their ability to fill off-payroll worker vacancies nor the rates paid to off-payroll workers had changed since April 2017.

It is clear, however, that it has not all been plain sailing. HMRC’s report that “most public authorities” have not experienced major difficulties with the new rules implies that the reform has been a struggle for some public authorities and that some sectors may be more affected than others. Further, HMRC acknowledge that many public authorities would have preferred more time to prepare and adapt.

Proposals for private sector reform

Lead proposal

The government’s lead proposal, as detailed in the consultation, is to extend the public sector off-payroll rules to the private sector. This would make private businesses responsible for assessing the employment status of a PSC contractor (i.e. whether such contractor would be self-employed or an employee if engaged directly by the end user). In the event that the end user’s classification proves to be incorrect, the end user (rather than the PSC, as is currently the case) would be liable for unpaid employment taxes.

Alternative proposals

As an alternative to the lead proposal, the consultation also discusses measures to encourage or require businesses to help ensure that their PSC contractors are complying with the current off-payroll rules. This could involve end users being required to perform

additional due diligence on off-payroll contractors, such as checking the history of labour supply chains and requiring PSCs to provide evidence of payments of employment taxes to HMRC (how the latter would work where a PSC contractor continues to take the view that the arrangement is a genuine self-employment is not made clear).

End users could also be required to ask the PSC to provide a completed CEST determination. CEST is HMRC's online 'check employment status for tax' tool. If CEST determinations were made compulsory, there could be some form of penalty for end users who have failed to carry out that check, such as disallowing a tax deduction for the costs of using labour from an unchecked supply chain. Alternatively, end users who have failed to ask for a CEST check and are later found to have used a PSC contractor who is in breach of the off-payroll rules could be 'named and shamed' publicly.

A difficulty with that approach is that (as admitted by HMRC) CEST does not provide a clear answer in at least 15% of cases. Further, an inconclusive result is perhaps more likely in the case of sophisticated arrangements involving the provision of professional services, where the analysis may seem less clear cut. For example, CEST does not take into account that, in a regulated industry, a consultant's ability to exercise control over work or to delegate work to a substitute may be restricted by the rules of the relevant professional body. The consultation document does not go into what the consequences of an inconclusive CEST result should be.

Where do we go from here?

HMRC's positive assessment of the public sector reform would suggest that a corresponding private sector reform will be their preferred option.

Further, the consultation document admits that the alternative proposals requiring enhanced due diligence by end users would place a relatively large administrative burden on businesses, without directly tackling non-compliance with the current off-payroll rules by PSCs. Such recognition of the disadvantages of the alternative proposals would suggest that making end users directly responsible for employment taxes in relation to their PSC contractors is the more likely outcome.

Given the complexities of the proposals for private sector reform and HMRC's acknowledgement that public authorities would have liked more time to prepare for the public sector reform, it is hoped that the government will take the time to properly consider responses to the consultation and not rush the implementation of legislation. This would favour April 2020, rather than April 2019, as the date for new rules to take effect.

It is also hoped that a reform of the employment status rules (as per the separate employment status consultation) will provide more clarity on the interaction of the relevant employment and tax rules and result in CEST being developed into a more effective tool. Such measures should also have a positive effect on IR35 compliance.

Further information on timing, and possibly on how the proposed reform of the private sector off-payroll rules will interact with the review of the employment status rules, is expected to be made available when the government publishes responses to the consultation in the autumn.

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