

Employment Intermediaries and Personal Service Companies – Potential Extension of Public Sector UK Tax Rules to the Private Sector

24 January 2018

This update relates to the UK government’s announcement that it will be consulting on making changes to the off-payroll taxation rules (commonly referred to as IR35) in early 2018. It is expected that such consultation will be published no later than the government’s Spring Statement (scheduled for 13 March 2018).

If the proposed changes were implemented, the IR35 rules applicable to the private sector would be aligned with the rules applicable to the public sector, with the result that private businesses engaging consultants through intermediaries may become liable to pay and account for employment taxes.

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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 (“NICs”) 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 NICs are triggered, and these are calculated by reference to the amounts paid to the PSC for the provision of services by the individual.



Responsibility for compliance with IR35 – changes to the public sector IR35 rules

Up until (and including) the tax year 2016/17, the responsibility for compliance with the IR35 legislation (including the obligation to pay and account for employment taxes as necessary) was with the PSC rather than the end user.

With effect from the tax year 2017/18, the rules were changed for arrangements in the public sector so that responsibility for compliance with IR35 shifted to either the relevant public body (as 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.

HM Revenue & Customs (“**HMRC**”) are understood to consider this change a success. The minutes of an IR35 Forum Meeting (held in July 2017) report that an online tool used to obtain HMRC’s view on whether IR35 applies to an engagement¹ had been used approximately 450,000 times since its launch on 2 March 2017 and was able to reach a determination 85% of the time, with more complex arrangements resolved through further guidance and the IR35 helpline. The period under review (March to July 2017) includes the first three months after the new public sector rules came in force, which suggests (although there is no data currently available to back this up) that the public sector reform may have contributed to the tool’s popularity.

The change to the public sector rules is also reported to have caused a significant reduction in the number of consultants engaged by the public sector, increased pressure on the level of consultant fees, and resulting delays for government projects. However, HMRC have dismissed those reports as ‘anecdotal’ and pointed out that they have yet to see evidence of significant impact on contractor attrition rates or delays to projects.

Potential changes to the private sector IR35 rules

Against this backdrop, it was announced in the 2017 Budget that the government would consult in early 2018 on a possible extension of the public sector IR35 rules (as revised with effect from the tax year

2017/18) to the private sector. If this change were implemented, responsibility for IR35 compliance would shift from the PSC to the private sector end user (or to an agency if payments to the PSC are made through a chain). As a result, the private sector end user (or agency) would be required to determine if IR35 applied to an arrangement and, if so, the private sector end user (or agency) would be liable to pay and account for income tax and NICs through payroll.

HMRC’s assessment of the public sector changes suggests that every effort will be made to implement the proposal. One of the main concerns is whether this could make it non-viable for businesses to engage consultants off-payroll through PSCs. There are many legitimate commercial reasons why a business may prefer to engage a consultant instead of an employee, including the need for flexibility in a challenging economic environment.

Furthermore, where an individual is deemed to be an employee of the end user for payroll purposes (as a result of applying IR35), this could be seen as an indication that the individual should also be treated as an employee for employment law purposes, with all of the rights and obligations associated with employment status. This may not be in line with the end user’s commercial objectives and could result in disputes. It is hoped that the employment status discussion (also announced to be happening in 2018 as part of the UK government’s response to the Taylor Review of modern working practices) will provide some clarity for the future on the interaction of the relevant employment and tax rules.

In view of the government’s commitment to carry out a full consultation, it is considered unlikely that any change to the private sector IR35 rules would come into force before April 2019 or have retrospective effect – although neither can be ruled out at this stage. Further information on timing should be made available as part of the forthcoming consultation.

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¹ Available at <https://www.gov.uk/guidance/check-employment-status-for-tax>