A contractor's guide to the off-payroll working rules

Recent adjustments to the off-payroll rules have resulted in major changes for contractors supplying their services through limited companies. This guide offers a concise overview of the rules and how they apply.

Updated on 18th March 2020

What are the off-payroll payroll rules?

The off-payroll rules were introduced to prevent workers, who would otherwise be classed as employees, working through limited companies for the purpose of paying lower taxes. As off-payroll workers are paid through their own intermediary, typically through their own limited company, they pay Income Tax and National Insurance contributions (NICs) through a combination of salary and dividends.

Previously, contractors earning a rate of £220 per day or more or on contracts of more than six months had to provide assurances to the relevant public sector body that they are outside of IR35. However, the government believes that widespread non-compliance with the off-payroll rules was costing the exchequer £1.3bn a year in lost tax revenue.

In April 2017, the government introduced new rules that transferred the responsibility for determining employment status from the contractor to the public authority or agency responsible for paying the worker's fees. In October 2018 it was announced that from 2020 these rules would also apply to medium and large private sector firms.

Although it was confirmed in the March 11th Budget that the off-payroll reforms would go ahead, the government announced a subsequent delay of the reforms until April 2021 in light of the Covid-19 outbreak. **The delay formed part of a range of measures designed to help alleviate pressure on businesses and workers in the midst of the national crisis**.

Who needs to consider the off-payroll rules?

Anyone working through their own limited company, or similar, needs to consider the off-payroll rules if the client is a medium or large sized organisation. Although the rules currently only apply to contractors supplying their services to a public sector authority (as defined by the Freedom of Information Act 2000), those working in the private sector through their own limited companies should also begin to familiarise themselves with the rules **in preparation for 2021**.

How do the off-payroll rules work?

At the start of a contract, the engager will use **HMRC's online employment status tool, or something similar,** to determine whether the rules apply. HMRC's CEST tool attempts to determine the workers employment status with questions relating to their working practice while engaged on a contract. These questions broadly relate to the key concepts of Control, Substitution and Mutuality of Obligation:

Supervision, Direction and Control (SDC):

Does the worker exercise control over when, where and how the work is carried out?

Personal Service and Substitution:

Is the working arrangement a personal one, or does the contractor have the right to provide a substitution?

Mutuality of Obligation (MoO):

Is there an obligation from the client to provide consistent and paid work, along with an obligation from the worker to personally carry out this work?

Variations and exceptions to the off-payroll rules

The rules will not apply if the end client is a small company as defined in the Companies Act 2006.

If you work in the construction industry, you'll need to apply specific rules in order to stop tax and NICs being paid twice on the same earnings within the Construction Industry Scheme and off-payroll working rules.

If you're a foreign national who provides services through an intermediary based in the UK, you'll need to check if the off-payroll working rules apply.

The off-payroll working rules won't apply if the agency, umbrella company or similar third party that supplies the worker directly employs them and deducts Income Tax and NICs at source.

What happens when the off-payroll rules apply?

If the engager decides the new rules apply, then they will deduct tax and NICs from the contractors' VAT exclusive fee before payment is made and the contractor is treated as receiving a deemed employment payment.

For tax and NICs purposes, the worker is treated as having an employment with the fee payer, so once the contract ends they will be given a P45. The relevant pay and tax details will then be entered on the contractor's employment self-assessment tax return.

A Limited Company will still be able to make pension contributions on behalf of the contractor with relief being obtained through the company.

Whilst the 5% allowance to cover unspecified expenses in the public sector has been removed, the limited company can still claim tax-allowable business expenses that could be claimed by an employee working directly for a public sector organisation. In the private sector the allowance can still be claimed until April 2021.

What are the Penalties for not following off-payroll working rules?

In the private sector, the contractor is currently liable for any penalties. If you haven't applied the off-payroll rules correctly you can be charged interest and penalties on any Income Tax or NICs owed. If you think the rules should have been applied to previous contracts, HMRC advises contacting them immediately, as a voluntary disclosure is treated with more leniency. HMRC can go back up to six years to determine liability.

In the public sector, liability rests with the public organisation who is paying the contractor. These taxes can be backdated as far as 6th April 2017.

Impact summary of the off-payroll rules

Although HMRC has steadfastly maintained that the reforms have improved compliancy, unanimous feedback from tax experts, economists and financial bodies indicates a generally negative impact on the public sector. Concerns over liability led to blanket rulings in the public sector that automatically classified contractors as inside **IR35**. Many contractors were taxed as an employees while receiving none of the associated statutory benefits. Faced with this unfavourable position, 27% of public sector contractors left, leaving organisations like the NHS short of contingent staff.

There have also been ongoing problems with the government's online self-assessment tool, CEST. In many cases, the tool has provided insufficient or contradictory guidance on key determinants relating to the contractor's employments status. This has resulted in an increase in tax tribunals with HMRC on the losing side in 75% of these cases.

Following the publication of their consultation, the government released the Off-payroll Draft Legislation as part of the Finance Bill 2019-2020, confirming that the legislation would come into effect in both the public and private sectors from April 2020. The draft legislation fails to address concerns in several areas, including adequate guidance for the private sector businesses responsible for determining if IR35 applies to a contract.

Subsequently, there was a repeat of the widespread non-compliance seen in the public sector. Many of the top 100 FTSE businesses such as HSBC, Lloyds, Morgan Stanley and Barclays adopted a "no PSC" policy ahead of the reforms that forced contractors out of their limited companies and onto the payroll.

The unpopularity of the reforms led to an official government review of the off-payroll rules following a general election in December 2019. **However, the review simply concluded that the reforms were necessary**. A House of Lords sub-committee subsequently **launched an inquiry into the effects of the off-payroll reforms as part of their review of the Finance Bill**. The inquiry brought to light compelling evidence that the reforms had caused widespread damage and disruption.

Continued pressure from campaigners and the House of Lords sub-committee were instrumental in the government's decision to delay the reforms until 2021 following the covid-19 outbreak. Although the government has said that the delay is only temporary, many stakeholders hope that it will give businesses more time to prepare and government further opportunity to overhaul the legislation.

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