

## To PAYE or not to PAYE

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That is the question... *Matt Crawford* and *Sarah Hewson* consider the friction that will be caused by the changes to the treatment of PSCs due to take effect in April 2020

### What is the issue?

At the Autumn 2018 Budget, the chancellor announced the government's intention to extend the off-payroll rules introduced for the public sector to most private sector businesses with effect from April 2020.

### What can I take away?

Businesses will need to implement processes to not only determine employment status but also to document and communicate the reasons behind the decision. Public sector clients will need to understand how the new regime differs from the current position.

### What does it mean to me?

The shortage of guidance on how to make appropriate status determinations means that disputes between end users, intermediaries such as agencies and individuals engaged via PSCs are somewhat inevitable.

Once the proposed changes to the treatment of workers engaged via a personal service company (PSC) take effect in April 2020, disputes between end users, intermediaries such as agencies and individuals engaged via PSCs are somewhat inevitable. This article outlines the key points that businesses will need to consider, and the processes which should be put in place to ensure the effective and timely handling of any disputes.

## Background

The employment intermediaries rules (often referred to as 'IR35') were introduced with effect from 6 April 2000 to address the potential loss of revenue from individuals seeking to avoid paying employee income tax and National

Insurance (NI) by supplying their services via an intermediary, e.g. a personal service company, instead taking income as dividends.

The IR35 rules introduced an obligation on the intermediary to assess whether, but for the existence of the intermediary entity, the individual providing services would be deemed an employee of the end user for tax purposes (often referred to as 'deemed employment status'). Where it was considered that an individual would be deemed an employee of the end user, the worker was treated as an employee of the intermediary so that the intermediary was required to calculate the amount of deemed employment income from that engagement (using the formula prescribed in legislation) and account for Pay As You Earn (PAYE) and NI (employee and employer) to HMRC on the requisite amount.

## **Introduction of specific IR35 rules for the public sector**

With effect from 6 April 2017, all payments made to PSCs by public authorities (as defined by the Freedom of Information Act 2000), or in relation to contracts with agencies and third parties that contract with the PSC to supply the services of a worker, are subject to deduction of PAYE and NI if deemed employment status applies. As a result, such contracts no longer fall within the original IR35 rules.

To assist with this, HMRC introduced the Check of Employment Status for Tax (CEST) tool (replacing the Employment Status Indicator tool) in March 2017. Unlike previous iterations, HMRC assert that reliance can be placed on the results of this tool. However, this is reliant upon the questions being answered fully and accurately, which is often difficult in practice, especially where the public authority is not the fee payer.

## **Proposed changes to the IR35 rules**

At the Autumn 2018 Budget, the chancellor announced the government's intention to extend the off-payroll rules introduced for the public sector to most private sector businesses with effect from April 2020. The government published its response to the off-payroll working rules consultation and associated draft Finance Bill clauses on 11 July 2019, which confirmed the following points.

### **Broad alignment**

Changes are to be introduced to the public sector, such that the rules for the public and private sector will broadly be aligned. Public sector clients will therefore need to understand how the new regime differs from the current position and update their processes accordingly.

### **Date of introduction**

The new rules will apply to payments made to workers on or after 6 April 2020.

### **Reasons for assessment**

One crucial difference between the proposed rules and those operating already in the public sector is that the end user will not only be required to pass on their assessment of the employment status (referred to as the 'Status Determination Statement' (SDS)) to the worker and any intermediary (such as an agency) but also the reasons for the assessment.

It is currently unclear how much detail will need to be provided on the rationale which underpins the end user's assessment. However, businesses will need to implement processes to not only determine employment status but also to document and communicate the reasons behind the decision.

### **Exemptions**

Private sector end clients qualifying as 'small' will fall outside the scope of the new rules.

For incorporated businesses, the Companies Act 2006 definition will be used to determine whether or not the end user

is small.

For unincorporated businesses, a simplified test will be applied, with the rules applying in the tax year following any calendar year in which a business's turnover exceeds £10.2m.

Where the above tests have not been met, a business may still be considered as medium or large for the purposes of the IR35 rules for the relevant tax year where the parent company or undertaking of the group does not qualify as small or the turnover threshold is breached when the business's turnover is combined with the turnover of connected persons.

### **Public sector end users**

Public sector end users (and relevant subsidiaries) will continue to fall within the scope of the new rules even if they would otherwise qualify as small.

### **Transference of liabilities**

There are a number of circumstances in which liabilities can be transferred to another party in the supply chain; for example, where information is not shared in the relevant time scales. The transfer provisions first apply to any entity which has failed in its obligations, then to the next entity in the supply chain and finally to the end user itself. However, the precise circumstances in which the transfer of debt provisions would be invoked and what timescales would constitute a 'trigger' when there is an ongoing dispute are as yet unclear. Further guidance is expected in this area.

### **Disagreement process**

The draft legislation also sets out an end user-led status disagreement process. This is covered in further detail below.

### **Disputes**

Whilst disputes with contract workers were always likely to occur, the inclusion of a framework enabling such workers to dispute the employment status determination made by the end user, coupled with little guidance on how to make appropriate status determinations, renders this somewhat of an inevitability.

As currently drafted, the legislation places the obligation to make arrangements to consider any disputes about the employment status determination with the end client. Such a challenge may be received from either the worker or the entity which is deemed to be the employer for the purposes of the new rules (e.g. an agency).

End clients should therefore develop and implement their own processes to resolve disagreements. The legislation does not specify how such processes should work in practice but does include a requirement to respond to representations within 45 days. The response must either confirm that the original determination is upheld; or, if it involves a revised status determination, a new SDS must be provided in line with the arrangements outlined above. Failing to do so could result in the PAYE/NI liability being transferred to the end client.

Efficient dispute resolution protocols are therefore likely to be required for cases where a worker or agency disagrees with the reasons which have been provided; and businesses will need to balance the administrative costs of passing on a detailed assessment with the risks of giving too little information and thus increasing the risk of challenge by the worker/agency.

Having a good system to assess the status of the worker and clearly documenting the reasons behind any determination will therefore be crucial in minimising disputes. HMRC have committed to release an improved CEST tool, which (potentially supported by other tools) could have an important role to play, provided all parties can put faith in the results it gives. HMRC have not yet announced when the improved CEST will be available, but it is understood to be in testing.

It is worth noting that the legislation does not currently place any time limits for any challenge to be made by a worker or agency, such that theoretically a challenge could be made some time after the SDS was issued.

It is therefore crucial that end clients:

- devise a process for any representations to be made and how these should be addressed/resolved;
- determine who oversees the process in relation to and/or is responsible for handling any challenges; and
- clearly communicate to whom any representations should be made to workers or agencies, e.g. including wording in the SDS directing them to where the process is published.

End clients should consider putting a clear written dispute policy in place addressing and outlining the above and ensure that this is reviewed on a regular basis.

Any policy should also address the approach where there is no change to the status determination. A worker is unlikely to be happy with the decision, which has the potential to impact the working relationship. Businesses must therefore consider how to handle any ongoing dispute and the steps to be taken if this impacts the services, which may ultimately lead to termination of the engagement. Thought should be given as to whether any changes need to be made to the contract to enable the contract to be terminated in these circumstances.

Additionally, businesses should keep good records and evidence of any decisions for the purposes of handling any future enquiries from/disputes with HMRC.

## **Conclusion**

End clients need to ensure they have a clear process in place to receive and resolve disagreements to avoid both damaging the relationship with the worker or agency, and/or any PAYE or NI obligations passing to them.

Businesses will also need to be agile in responding to further changes or clarification of the rules as they prepare for the implementation of the rules in April 2020 and any future changes which may be made, such as changes expected to the employment status tests to align with the plans set out in the government's Good Work Plan.

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