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# Extension of the off payroll rules into the private sector

## What's happening and when?

On 6 April 2020 the IR35 rules in the private sector will change. In brief the IR35 rules apply where an individual works through an intermediary, such as a personal services company, and provides their services to an end user client. If that intermediary did not exist, but the individual looked like an employee of the client for tax purposes, then that assignment is deemed to be 'inside IR35' and the individual's pay should be subject to PAYE tax and national insurance. Employers' national insurance will also be due. Under the current IR35 rules in the private sector the intermediary is responsible for assessing the individual's status. However in April 2017 the rules changed in the public sector – under these 'off payroll rules' the public authority which is the end user client must assess status for tax purposes. If the role is inside IR35 then the fee payer (which is the party next to the intermediary, usually an agency) must make the appropriate deductions before it pays the intermediary. The agency then reports those payments via its Real Time Information (RTI) report. If the role is 'outside IR35' the intermediary remains responsible for tax and national insurance.

The Government believes that there is significant non-compliance with the IR35 rules in the private sector and so in 2018 consulted on how to best improve compliance in that sector. At Budget 2018 the Government confirmed that it would extend the off payroll rules into the private sector from April 2020.

The information provided here is based on the [government's consultation response document](#) and discussions within the [IR35 Forum](#) of which the REC is a member.



## What do the changes mean for the end user client?

End user clients will have to assess the IR35 status of each assignment where the services are provided by a contractor working through an intermediary. This means that the end user client will have to understand the IR35 rules and use an appropriate assessment tool to reach an accurate decision. The Government has produced an online 'Check employment status for tax' tool (CEST) and provided the information put into the tool is correct at the time, HMRC have said they will stand by the result it produces. In order to properly assess tax status, clients will have to answer questions such as:

- Does the contractor have a material interest in the intermediary (e.g. does the contractor own more than 5% of the shares – if not, the rules do not apply).
- Does the client require the contractor to personally provide their service or will the client permit substitution or sub-contracting?
- What financial risk does the contractor take? e.g. will they have pay to correct work themselves?
- Does the contractor have multiple clients or are they reliant on the client for most of their work?
- How long will the assignment last?

However there are industry concerns about CEST and as it is not obligatory to use this tool, clients could use any IR35 review tool they wish. The question will be whether agencies will want to rely on the results of other tools, particularly if they are liable for the status decision. The client will then have to pass the status decision to the agency it has a contract with.

In their [consultation response document](#) the Government propose an exemption for end user clients which are small companies. They propose using a definition of small companies similar to the definition used in the Companies Act 2006 which is: a company which in a particular financial year meets two or more of the following conditions: (1) has a turnover of not more than £10.2 million, (2) a balance sheet total of not more than £5.1 million or (3) not more than 50 employees. So clients and agencies alike will need to know whether the client is a small company, and therefore exempt from the changes. Agencies are likely to require indemnities from clients who declare that they are small companies and therefore exempt, but who may be deemed later not to be exempt. REC is concerned that such an exemption will significantly increase the complexity and administration burden on agencies. We are interested in members' feedback on this proposal.

## What does it mean for the agency?

Where the agency is the fee payer it must act on the client's status decision. Where the decision is an 'outside IR35' decision the fee payer (which is the party closest to the intermediary, usually the agency) can pay the intermediary gross and the intermediary will remain responsible (as it is now) for all tax and national insurance matters. However where the decision is an 'inside IR35' decision, the fee payer will have to deduct PAYE tax and national insurance before paying the intermediary. Employers' national insurance will also be due so the agency will charge the client an equivalent sum.

These payments will be reported via RTI and so will add to the agency's payroll figure for apprenticeship levy purposes.

## What does it mean for the contractor?

When the role is 'inside IR35' the intermediary will no longer be responsible for tax and national insurance. As tax and national insurance will be deducted by the agency from the gross sum due to the intermediary, the intermediary will receive a lower net sum for onward payment to the contractor. The intermediary will still be responsible for expenses, VAT and corporation tax. Contractors may seek higher rates of gross pay to make up for the shortfall but experience in the public sector has been mixed – some clients will pay an uplift to retain the services of a particular contractor but others will not as they also face an increased employers' national insurance bill.

Importantly, employment status for tax purposes is not the same as employment status for employment rights purposes. There are a number of cases where status has been challenged for tax purposes whilst there are others where the issue has been employment rights. However at the moment there is no direct correlation between tax and employment status.

## Next steps

At the time of writing we are waiting for the next consultation which will be on the detail of the changes. We expect the consultation in early 2019 and the REC will respond to it. We then expect draft legislation to be published in Summer 2019 but based on that timing, we do not expect final legislation until December 2019 at the earliest so turnaround time for contracts and finalising processes may be quite tight. In the meantime we have produced a [flow chart](#) to help agencies identify when the off payroll rules will/will not apply and what to do when they do apply.

Clients should start to assess who amongst their contractor populations might be affected by this change. They must also identify who within their organisation should make the status decisions and ensure that those individuals understand how to assess status. Agencies will have to ensure that they have the payroll capabilities to manage payments to contractors (we understand from the public sector roll out that this is far from straightforward and some agencies have incurred significant development costs). Agencies should also be aware 'innovative' or 'HMRC approved' solutions to these changes.

**The REC will keep members updated throughout 2019.**

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