ADDLESHAW GODDARD

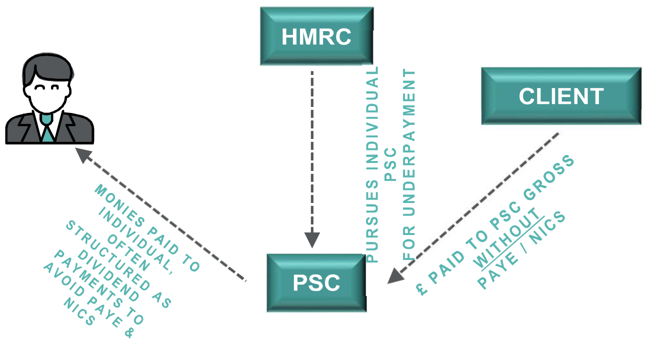
PERSONAL SERVICE COMPANIES – TAX CHANGES

Planning for the new tax obligations on private companies using off-payroll workers

The current law

HM Revenue & Customs (**HMRC**) has, for a number of years, sought to combat the perceived tax avoidance of workers supplying their services to clients through an intermediary (such as a "personal service company" (**PSC**)). As the use of PSCs has increased over the years, so has HMRC's scrutiny of such arrangements.

In 2000 HMRC introduced rules to tackle the use of PSCs (**IR35**). Broadly, those rules imposed obligations on the PSCs to account for PAYE income tax and NICs (including employer's NICs) on payments to the PSC if the individual's status would be one of employment were the individual to contract directly with the client. As a result of this the PSC bore the tax risk of incorrectly assessing the status of an individual, rather than the client.



Under IR35, therefore, clients were often at a tax advantage when they hired off-payroll workers through a PSC, rather than directly, as the PSC, rather than the client, would be pursued by HMRC for any incorrect assessment of the individual's status.

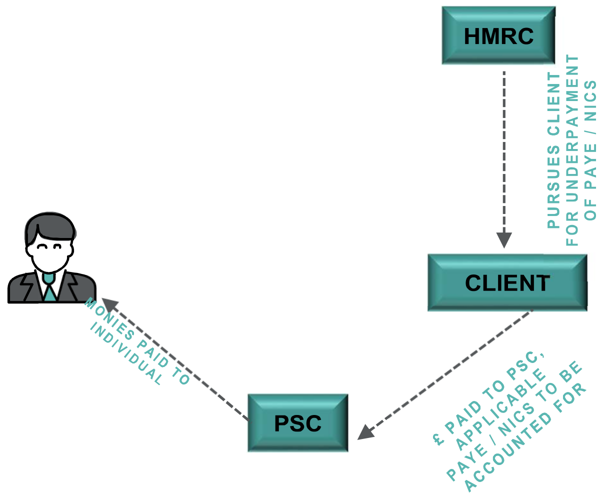
However, the government considers that compliance by PSCs is low, and that this lack of compliance will result in lost tax revenues of up to £1.2 billion by 2022/2023. In addition, the current rules are time intensive for HMRC – HMRC must pursue individual PSCs for underpaid tax (rather than going after 1 client).

What is changing

From April 2020 the way IR35 operates will change for large and medium sized businesses using PSCs, so that:

- the businesses will become responsible for assessing the status of an individual working via a PSC (applying a fiction that the individual is engaged directly by the business; and
- the direct payer of the PSC (not always the business itself) will be responsible for any PAYE and NICs arising in respect of such arrangements.

The above changes will bring large and medium sized businesses in line with public sector bodies using PSCs (who have been subject to the above since April 2017).



As a result, businesses will no longer be able to safeguard themselves against PAYE/NIC risk relating to employment status by simply employing individuals through a PSC.

In order to assist businesses (and public sector bodies) to determine the PAYE obligations associated with a PSC, HMRC has developed a "check employment status tool" (**CEST**). However, feedback on CEST is mixed and HMRC will only stand by a CEST answer where it considers that the questions have been answered correctly – given the nuances of "employment status" and the fact that such a check may be done before the PSC is engaged, it will often be the case that a CEST answer cannot be completely relied upon. HMRC has stated that it is looking to improve CEST "to ensure it reflects the needs of the larger and more diverse private sector".

What companies need to be doing now

Notwithstanding the fact that the rules do not come into effect until April 2020 it is recommended that businesses begin to take action now.

- Processes and systems (including payroll and accounting) for engaging workers may need to be amended in order to record employment status decisions and account for PAYE and NICs.
- Staff training may be needed to ensure the employment tests are fully understood (and in particular in order to be able to rely on CEST). CEST in its current form may not be compatible with particular sectors – businesses in those sectors will have to determine how best to assess the status of an individual.
- Communications with relevant PSCs should be considered at an early stage – individuals may be concerned about possible changes to net pay.
- The financial impact of the changes will need to be considered (employer's NICs will be an additional cost to the business) and businesses should decide how to account for tax in situations where the employment status of an individual is unclear.
- Current contracts with PSCs will need to be reviewed to determine the employment status and ensure that any applicable PAYE and employees NICs can be deducted from any payments to a PSC.
- Reputational issues can arise if businesses are seen to be slow / unduly cautious in their approach to employment status – issues may arise if individuals disagree with the business' determination on employment status (and PSCs may challenge the ability for PSCs to deduct PAYE / NICs from PSCs).
- For companies that cannot recover their VAT in full, and where an individual is determined to have "employment status" for PAYE / NICs purposes, it may be beneficial to engage the individuals as employees (thereby avoiding additional VAT costs associated with PSCs).

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