UK - Off-Payroll Labour And Cross-Border Issues

Why The Off-Payroll Rules Matter

Last March we wrote to advise all readers that the UK Government was to introduce new legislation from April 2020 to help tackle the perceived abuse of tax and national insurance contributions (NIC) relating to off-payroll labour in the private sector (extending the rules in place for the public sector since April 2017). Shortly after that article, the Covid-19 pandemic struck and the Government then decided to postpone the introduction of the new off-payroll rules in order to help alleviate immediate issues facing all taxpayers.

Despite protestations to the contrary, the Government has today (3 March 2021) again confirmed that the new rules will apply from 6 April 2021, one year later than originally envisaged. Due to the importance of this topic we have re-run our original article, updating it as appropriate.

HR teams must now get to grips with the new rules to manage the impact on their businesses. In the short-term, businesses that use large numbers of contractors could face difficulties in sourcing the right workers, and there are potentially large NIC costs arising from the new rules. There are significant new administrative responsibilities and, in time, potential penalties and interest charges (not to mention reputational risks) from getting things wrong.

Summary Of Off-Payroll Rules

Commonly referred to as the 'IR35 Reforms', the changes will affect medium and large private sector businesses that use workers operating through an intermediary. An intermediary is usually a worker's personal service company (PSC), but could also be a partnership, an LLP, a managed service company or even an individual. The rules are designed to ensure that where the individual works like an employee, but provides services through their PSC, they broadly pay the same tax and NIC as they would if they were a direct employee.

Currently, the responsibility lies wholly with the PSC (in effect, the worker) to ensure the IR35 rules are considered and applied as necessary (i.e. full employer's and employee's NIC is paid). From April 2021, it will be the responsibility of the organisation receiving the worker's services (the end user) to determine whether the IR35 rules apply.

It is important to remember that there have not been any changes to the tax rules governing employment status: workers should be regarded as a deemed employee if they are providing services that, but the existence of an intermediary, would constitute fulfilling a contract of service for the end user.

Where the end user carries out a status determination on the contract with 'reasonable care' and determines the worker falls within the new rules, the responsibility for then applying the correct tax treatment to payments made to the PSC will lie with the organisation paying the PSC, defined as the 'fee payer'. The end user business and the fee payer may or may not be the same organisation.

There is an exemption for small businesses using contractors, and here the responsibility for applying the IR35 rules remains with the PSC. While the definition of small for these purposes follows the Companies Act definition of 'small' it is not identical, nor is it straightforward for businesses on the cusp of the turnover, balance sheet value and staff number limits. HMRC has previously confirmed that there will be a duty on businesses to confirm whether or not they are 'small' if a prospective contractor asks them.

Who Is The 'End User' And Who Is The 'Fee-Payer'?

The end user is the organisation in the supply chain that is ultimately receiving the individual's personal services. The end user is responsible for determining whether the individual would have been regarded as an employee if they were engaged directly.

If the end user determines the IR35 rules apply, the fee-payer is treated as the employer for the purposes of income tax and NIC. The fee-payer is the organisation paying the PSC for the worker's services.

For example, an individual supplies IT services to A Ltd through their PSC (Fig. 1).

In this case A Ltd is the client as they are receiving the individual's IT services. As the party responsible for paying the individual's PSC, A Ltd is also the fee-payer.

As the end user, A Ltd is responsible for reviewing the individual's engagement status and determining whether the individual falls within the IR35 rules. If A Ltd decides that the IR35 rules apply, it will then be liable, as the fee-payer, for secondary Class 1 NIC and, where applicable, the Apprenticeship Levy. It will also be responsible for deducting tax and NIC from the payments made to the PSC. As the deemed employer, A Ltd must remit payments to HMRC and submit information about the payments using Real Time Information.

Where there are numerous parties involved, it is important to determine who the client and fee-payer are; they may not always be the same organisation. Where the worker is engaged via an agency, the obligation to deduct income tax and NIC would fall on the agency or organisation in the labour supply chain making the payment to the PSC.

For example, an individual supplies IT services to A Ltd through their PSC and via an agency (Fig. 2).

A Ltd is the end user and makes payment to the agency. As the end user, A Ltd is responsible for assessing if the IR35 rules apply and determining the IT worker's employment status. If A Ltd determines that the worker is a deemed employee, it will fall on the fee-payer to make the necessary tax and NIC deductions. It is the agency that pays PSC Ltd for the work undertaken by the individual, and the agency is therefore the fee-payer in this arrangement.

However, where one or more agencies is involved in the labour supply chain there is a potential overlap with the existing rules offshore intermediaries in labour supply chains (see below).

Fig. 1

Fig. 2

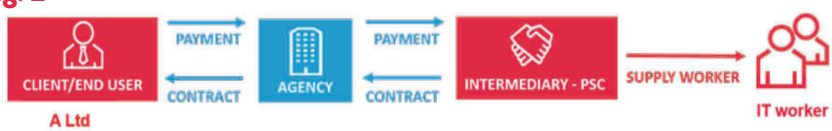
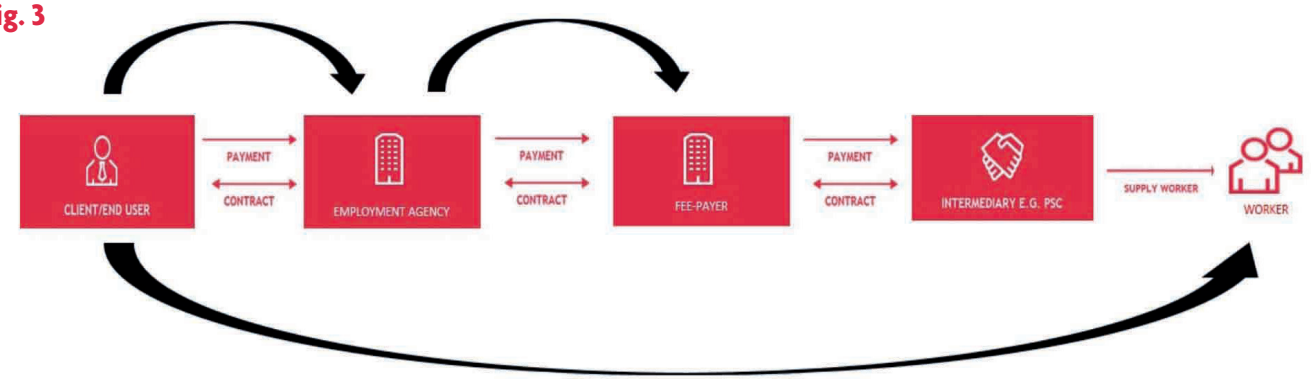


Fig. 3



Responsibility For Communicating The Status Determination

When a business has reviewed a worker's status, regardless of whether the business concludes that a deemed employment exists, it must give the worker a Status Determination Statement (SDS) confirming its conclusion and the reasons behind that conclusion.

If there is a labour supply chain involved, the determination must be passed down each stage of the chain by each party until it reaches the fee-payer. The fee-payer is the entity which pays the intermediary through which the worker supplies their services. It is wise to document this clearly as, if a party receives the SDS but does not communicate it down the labour supply chain, that party becomes the fee-payer. As the fee-payer, they will then be responsible for deducting tax and NIC (and paying it to HMRC) until the determination is passed on to the ultimate fee-payer.

In Fig. 3, the black arrows mark who is responsible for passing the SDS to which party.

Reasonable Care

The status of a worker is not always straightforward, and a number of factors will need to be considered. Having a transparent process within the business will reassure workers that their status has been fairly reviewed. It is important that businesses do not make any blanket determinations; the business has an obligation to review each worker's position on a case-by-case basis, and must be able to demonstrate that 'reasonable care' has been taken in making a determination.

HMRC's View Of 'Reasonable Care'

HMRC has recently published its policy statement on "compliance principles" for the new regime. This is important for businesses, because it sets out how HMRC will enforce the rules and what standards of compliance it expects when they engage contractors.

The 8 key principles that HMRC will follow are:

- We will support customers who are trying to do the right thing and comply with the rules
- We will help customers meet their responsibilities under the off-payroll working rules
- Where customers make a mistake, we will help them correct it
- We will check that mistakes are corrected
- We will identify and correct non-compliance with the off-payroll working rules
- We will challenge deliberately non-compliant customers
- We will challenge tax avoidance schemes that claim to avoid the off-payroll working rules or otherwise reduce the tax payable
- We will use a specialist team to carry out all our off-payroll working compliance activity.

These seem perfectly sensible principles but they make it clear that HMRC expects businesses to make serious efforts to get things right. As with most of the UK's tax rules, HMRC can charge interest and penalties if the correct taxes are not paid on time. Please don't forget that the off-payroll rules can make a business liable for PAYE and NIC that another business should have deducted!

Fortunately, HMRC's new policy statement specifically says that where it finds mistakes in a taxpayer's handling of the off-payroll labour rules, it will not charge tax penalties where the business can demonstrate that it took 'reasonable care' in applying the rules. Our suggested steps are:

- **Step 1 -** Get expert help to assess your situation and risks
- **Step 2 -** Adapt your processes so it is easier for you to comply
- **Step 3 -** Communicate about your new processes, and train team members
- **Step 4 -** Document everything!

For more information do check our website https://www.bdo.co.uk/en-gb/insights/tax/global-employer-services/off-payroll-labour-how-to-prove-you-take-reasonable-care-over-contractors

Disagreement Process

There will be a right of appeal, and although there is no formal appeal mechanism, an end user will be required to introduce a process to consider any appeals. Where the worker contests the determination, the end user must respond to the worker within 45 days. If the end user concludes that the original determination is correct it must provide reasons for its conclusion and reissue the SDS. If the end user concludes that its initial determination was incorrect, it must issue a new SDS (and withdraw the original SDS). Failure to respond to the worker with the 45 days may result in the client being treated as the fee-payer and becoming liable for tax and NIC.

Who Is Doing What, And Where Are They Doing It?

When it comes to cross-border working, it is important to note that the off-payroll rules do not always apply to a UK end user business (but other rules may). Whether or not they apply depends on whether or not the end-user and contractor are UK resident for tax purposes, and where the work is carried out: if the answer to two out of these three criteria is 'outside the UK' then the off-payroll rules will not apply. It is vital to know the status of all parties and the location in which work is carried out (Fig. 4 on next page).

Overlap With The Offshore Intermediary Rules

The offshore intermediary rules were introduced in 2014 to address arrangements involving offshore labour agencies that sought to avoid income tax and NIC. The basic mechanism is that when there is a labour supply chain that involves offshore companies providing workers, and the end user business is in the UK and the work is carried out in the UK, HMRC will seek PAYE and NIC from the intermediary closest to the end user if it is unable to pursue the offshore intermediary. However, if the offshore intermediary contracts directly with the end user, it is the end user that will be held responsible for any PAYE and NIC.

Where Supplier Not A PSC Or LLP - Don't Forget The Host Employer Rules

Of course, the new off-payroll labour rules are not the only complication for international HR advisers to grapple with. The off-payroll rules will not apply if a contract worker is supplied by a company that is not a PSC or staff agency. However, where an individual is carrying out duties in the UK and his or her overseas employer does not have a UK

Fig. 4

END USER	Outside UK	UK	Outside UK[2]	Outside UK[2]	UK	Outside UK	UK	UK
PSC/LLP[3]/ INDIVIDUAL	Non-UK resident	Non-UK resident	UK resident	Non-UK resident	UK resident	UK resident	UK resident	Non-UK resident
SERVICES PERFORMED	Outside the UK	Outside the UK	Outside the UK	In UK[1]	In UK	In UK	Outside the UK	In UK[1]
DO OFF-PAYROLL RULES APPLY?	No - no SDS needed	No - no SDS needed[2]	No - no SDS needed	No - no SDS needed	Yes - SDS needed	Yes - SDS needed if end-user has UK PE	Yes - SDS needed	High risk of host employer rules applying

1. A non-UK PSC is deemed to have a place of business in the UK if the worker is resident in the UK and carries out the work in the UK (S56(7) ITEPA 2003).
2. Assuming the group has no permanent establishment in the UK.
3. Not all LLPs are relevant (see below).

Note: if worker is resident in the UK, their PSC is always likely to be UK resident, but this may not be the case for an LLP comprised of many partners.

permanent establishment, but the employees are working at or under the control of another UK business, that business may be regarded as a host employer, and PAYE may have to be applied by the engager anyway under the host employer rules. Of course, the UK's Short-Term Business Visitor rules can simplify the administration duties in such cases.

Whether UK NIC is also payable depends on the worker's normal country of residence: for example, EU/EEA workers may be able to provide an A1 certificate to prove they pay social security contributions in their home country, so no UK deductions should apply. Similar certificates of contributions may be available where the worker is resident in a country which has a reciprocal social security agreement with the UK.

Directors And Non-Executive Directors (NEDs)

Overlaying the special rules for directors onto the new off-payroll rules creates more complexities.

Broadly, UK companies have to look at who the office holder is, who the payment is made to, and where the board meetings and other duties are carried out. Board meetings in the UK generally mean tax in the UK, but not always under PAYE, and not always within new off-payroll rules.

The starting point is that HMRC will treat a director or NED as an 'office holder' who is liable to PAYE on their UK duties. However, many more complex arrangements exist in practice, and a company can hold the office of director.

For example, Company B (not a PSC) is an office holder in company A but delegates its NED role to an individual. Company A pays company B for the duties of the NED, and company B pays corporation tax on those fees. While the individual is working in the UK and resident in the UK because they are supplied by another company that is not a PCS, then the off-payroll rules do not apply and no status determination need be carried out by company A.

Conversely, a professional service firm (an LLP) may provide an individual to take an office holder role at board meetings in the UK, but the fees are paid to the LLP. Where the fees go into the general profit pool of the LLP (not ring-fenced for the individual) there is no employment income under S6(5) ITEPA 2003. However, under the off-payroll rules, the Company would be prudent to carry out a status determination and document an SDS to confirm that no deductions were necessary, so that it can demonstrate that it has taken reasonable care.

Where an individual is not UK-resident but carries out board duties in the UK, the NIC concession for short visits to the UK to attend board meeting may apply - even if there is PAYE due on the fees paid under normal employment or the off-payroll worker rules.

International Groups

It is clear that the UK-based companies of international groups must now put comprehensive processes in place to manage their UK tax exposure when assessing roles from a procurement, HR and line management perspective. While HMRC will take a 'light touch' approach to enforcement penalties for the new rules in the first year end users (and fee-payers where a different entity) will still be expected to deduct and pay over the correct amounts of PAYE, employee's and employer's NIC. Equally, the use of contractors in the UK business will need to be carefully managed and documented to show that the business is taking reasonable care from April 2021 onwards.

In some circumstances, HR managers working across an international group may be able to reduce the impact of the new rules in the UK by considering where contracted out work is carried out. For example, it may be possible to delegate the task to an overseas subsidiary to carry out the task through a local contractor (although this may raise transfer pricing issues!). Alternatively, for specific types of work (e.g. IT design), a UK company may use its group contacts overseas to identify a non-UK resident contractor who can fulfil a contract with the UK company by working remotely overseas.

Conclusion

HMRC has previously acknowledged businesses' concerns over how they will apply the rules where there is a cross-border dimension to a labour contract. It has promised to publish more guidance on cross-border issues and I hope this updated article still illustrates why it is sorely needed!

For more information, please do review https://www.bdo.co.uk/en-gb/services/tax/global-employer-services/off-payroll-labour for latest updates and guidance.

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