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IR35: Are you responsible for your contractors' income tax and NICs?

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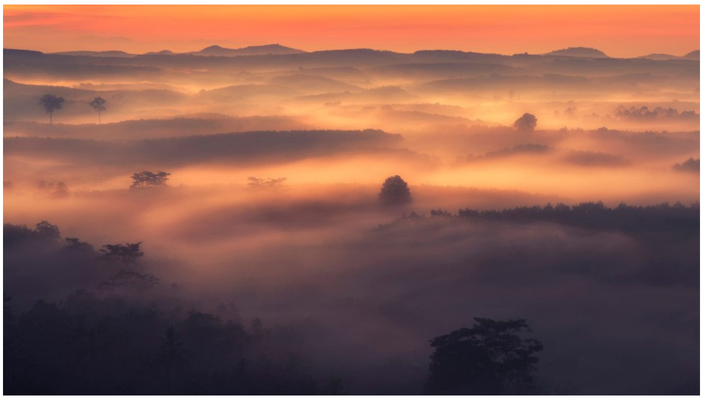

On both sides of the Atlantic, government authorities have been engaged in a crack-down on what they view as the 'mislabelling' of employees as contractors. In the UK, the Treasury has long held the view that a number of people claiming to be self-employed and operating through personal service companies (PSCs) are actually employees who should be paying tax accordingly. The news headlines of the past pointed to BBC reporters and even government department contractors who were operating through PSCs and paying themselves dividends to 'avoid' income tax and National Insurance contributions. The Government saw fit to combat this first in the public sector by holding end-user clients of PSCs liable for income tax and National Insurance contributions. From 6 April 2020, these same rules (known as IR35) will be rolled out to the private sector.

As a result of the new rules businesses entering into relationships with PSCs need to consider whether, if the PSC was removed from the arrangement, the individual would be an employee (for tax purposes) of the business. If so, that business (and not the PSC) would be responsible for deducting income tax and National Insurance contributions from the fees paid to the PSC. This squarely shifts the tax burden from PSCs to those clients who use and pay for their services, introducing a significant additional tax risk for such businesses which potentially undermines some of the advantages of PSC arrangements.

The Government is currently going through a second consultation exercise with a view to understanding how best to implement the reform in the larger and more diverse private sector. Business lobby groups such as the Institute of Directors are up in arms about the changes, which they say will add further red tape and lead to many businesses automatically – and potentially wrongly – classifying genuinely self-employed people as 'employees'. Those who wish to provide responses to the consultation are required to do so by 28 May 2019 and we anticipate that a large number of business groups will continue to raise concerns.

However, there is no suggestion that this extension to IR35 will be delayed or abandoned. With that in mind – and ahead of the change next year – businesses engaging PSCs and those who operate through PSCs need to get their house in order. Whilst the new rules should not apply to 'small' businesses (those with fewer than 50 staff or less than £10.2m annual turnover), we recommend that those who engage individuals through PSCs:

- assess whether those working through PSCs are caught by the rules;
- assess who will likely be primarily responsible for PAYE;
- if liability does lie with the engaging business, calculate, report and pay income tax and National Insurance contributions or consider alternative ways of engaging the individual.

For those individuals providing their services through PSCs:

- be prepared for the new rules which may impact how clients are prepared to enter into arrangements with such individuals and their PSCs;
- consider to what extent the new rules undermine the advantages of working through a PSC.

The test for whether an individual is an 'employee' is different for tax and employment law purposes. Therefore, as part of the reviews recommended above to deal with these tax changes, businesses should also consider the nature of the arrangement from an employment law perspective, as this can have implications on the entitlements of such individuals. The Government has promised to produce an improved online tool to help those involved in these arrangements make this assessment.

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