



Recruitment  
& Employment  
Confederation

# The Off-Payroll Rules

Factsheet for clients

# Extension of the Off-Payroll Rules to the private sector

factsheet for clients

Version 3

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## What's happening and when?

**What's happening?** The government is extending the off-payroll rules, which have applied in the public sector since April 2017, into the private sector. The new rules will apply to payments made to intermediaries such as personal service companies (PSCs). Importantly, the tests for IR35 status are not changing but the responsibilities for making the IR35 status decision and deducting tax and national insurance are.

**What's the difference?** From 6 April 2021, the PSC will no longer be responsible for managing IR35. Instead, the client must assess the IR35 status of each engagement, and if the client finds that the engagement is 'inside IR35', the fee-payer must deduct tax and national insurance before paying the PSC.

**When:** The new rules will apply to payments made to PSCs for work done on or after 6 April 2021.

## About this guide

- This factsheet is for clients that engage PSCs. It is for guidance purposes only and clients should always obtain their own legal advice.
- We include [hyperlinks](#) to external sources of advice. In particular, we include hyperlinks to HMRC's Employment Status Manual (ESM). This sets out HMRC's interpretation of the rules and includes scenarios to illustrate various key points.
- The advice contained in this document, all hyperlinks and figures are correct at the time of writing.

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# 1 A recap of IR35

## 1.1 What does 'IR35' mean?

The IR35 rules are set out in Chapter 8 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA)<sup>1</sup>. They apply where an individual (the 'contractor'\*) works through an intermediary, such as a personal services company (the 'PSC'\*), and provides their services to an end user client. The IR35 rules apply where the contractor has a material interest in the intermediary they work through:

- if it's a company, that means they own more than 5% of the company's shares<sup>2</sup> (the rules do not apply for example, when an individual works through an umbrella company because they will not own shares in the umbrella); or
- if it's a partnership, that means they are entitled to 60% or more of the profits of the partnership or most of the profits of the partnership which come from one client or one client and its associates.

\* For ease we will use the terms 'PSC' and 'contractor' throughout the rest of this guide. We also use the terms 'IR35' and 'off-payroll' rules interchangeably.

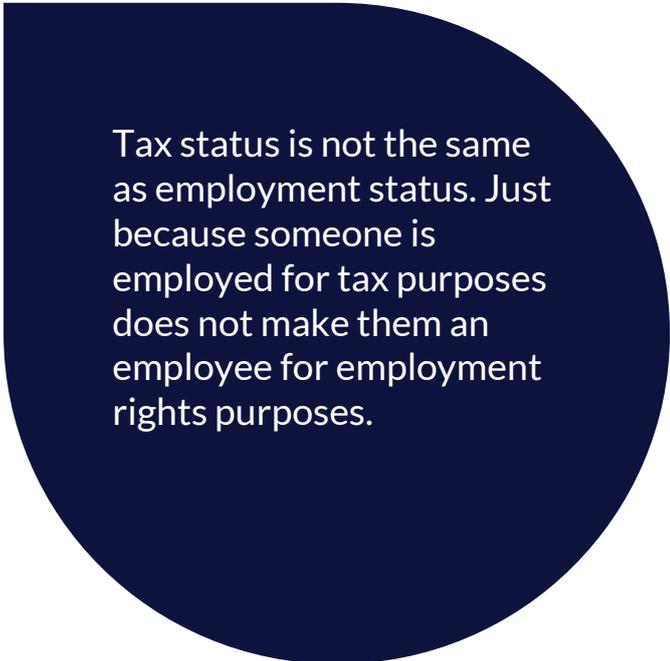
## 1.2 Inside or outside IR35?

The IR35 rules provide that if that PSC did not exist, but the contractor looked like your employee for tax purposes, then their assignment is deemed to be 'inside IR35'. That means that the contractor's pay should be subject to PAYE tax and national insurance. Employers' national insurance will also be due.

Office holder roles are automatically deemed to be Inside IR35. There is no statutory definition of the word 'office' but it has been defined in case law as a 'permanent, substantive position which had an existence independent from the person who filled it, which went on and was filled in succession by successive holders.'

**For more information on office holders see**

- [HMRC's ESM 2500](#)



Tax status is not the same as employment status. Just because someone is employed for tax purposes does not make them an employee for employment rights purposes.

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<sup>1</sup> The term IR35 is not set out in any legislation. It refers to Inland Revenue Notice 35 which set out the Intermediary rules. Similarly, terms used elsewhere in this document such as inside IR35, outside IR35, personal services company or umbrella are not defined in law but are commonly used terms.

<sup>2</sup> Section 51 ITEPA

## 2 Extension of the off-payroll rules into the private sector

The off-payroll rules (set out in Chapter 10 of ITEPA) were implemented in the public sector in 2017. They apply where the client is a public authority as defined in the Freedom of Information Act 2000 or the Freedom of Information (Scotland) Act 2002. Under the off-payroll rules:

- the responsibility for assessing IR35 status moves from the PSC to the end user client; and
- when the engagement is inside IR35 the responsibility for making tax and national insurance deductions moves from the PSC to the fee-payer (i.e. the party next to the PSC in the supply chain).

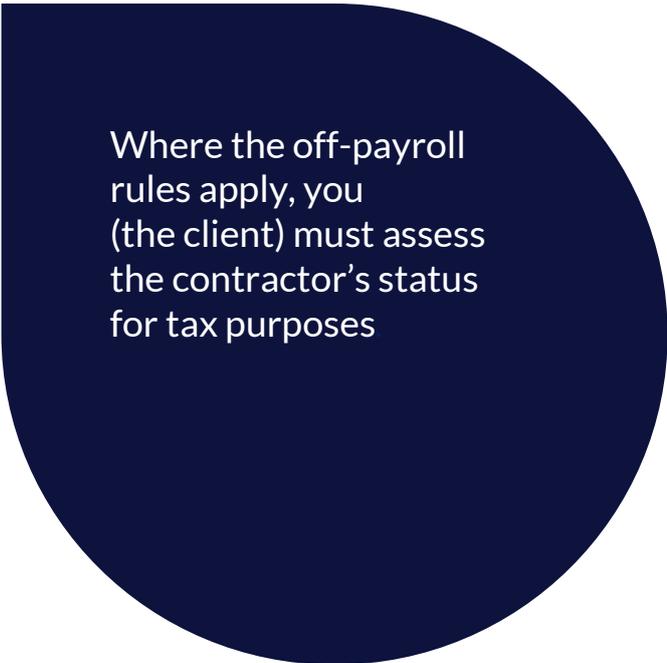
The off-payroll rules will be extended into the private sector on 6 April 2021, albeit with some amendments which will apply across the board. The rules will **apply to payments made for work done on or after 6 April 2021**.

Note that if you operate in the construction sector, IR35 and the off-payroll rules take precedence over the Construction Industry Scheme (CIS). This means that you and your agencies must consider IR35 first, and only if it does not apply, then consider CIS.

### 2.1 Does my business have to apply the off-payroll rules?

The off-payroll rules will apply to all public authorities, and private sector clients that are not exempt (see section 2.1.1). You should tell your agency if your business is exempt or not.

The off-payroll rules will apply where the contractor has a material interest in the PSC (see section 1.1) and so you will need to know which temporary workers are engaged through PSCs. That said, you should assess all roles where temporary workers are provided because you may not always know whether a temporary worker is a contractor working through their own PSC or working directly for the agency or through an umbrella company. Importantly, the rules will also apply if your business engages contractors directly rather than through an agency (in which case your business will be both the client and the fee-payer).



Where the off-payroll rules apply, you (the client) must assess the contractor's status for tax purposes

### 2.1.1 Exempt companies

*Small companies* will be exempt from the changes. A small company is one which meets two or more of the following criteria <sup>3</sup>:

- Annual turnover of not more than £10.2 million,
- Balance sheet total of not more than £5.1 million, or
- No more than 50 employees.

Companies in groups and joint ventures will be exempt provided all of the group companies or joint venture partners are small. Unincorporated organisations with a turnover of less than £10.2 million will also be exempt.

When an organisation becomes or ceases to be small in an accounting period, for the purposes of the off-payroll rules that change will apply from the start of the tax year following the end of that accounting period, irrespective of whether the organisation is incorporated or unincorporated. If your company becomes small you must tell the agency that the company is no longer medium or large (and therefore exempt) - and you must also withdraw any status determination statements (SDSs - see section 3) already given to the agency, with effect from the beginning of the tax year.

There will be anti-avoidance rules to prevent organisations restructuring to avoid the rules.

#### *How to tell your agency that your company is small and exempt?*

You do not have to proactively tell agencies that your company is small and therefore exempt. But if an agency (or a contractor) asks you to confirm the size of your company, you must respond to them within 45 days. If you do not respond within 45 days, then you will be deemed to be the fee-payer until you confirm you are exempt. Note that although the agency may ask you about your size before 6 April 2021, the 45-day clock only starts on 6 April 2021. Still, you will want to help your agencies and contractors by responding as quickly as possible. HMRC will produce a template for clients to advise agencies whether they are small (or not) and therefore exempt (or not). REC has also produced an exempt company declaration for its members to send to their clients.

**For more information on the exemption for small organisations, see:**

- The HMRC Employment Status Manual [ESM10006 to 10009](#)

*Overseas companies* with no UK connection will also be exempt <sup>4</sup>. An overseas company has no UK connection immediately before the beginning of the tax year where it:

- is not resident in the UK; or
- does not have a permanent establishment in the UK.

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<sup>3</sup> The small companies exemption is set out in Section 50 ITEPA. The small company criteria are set out in Section 383 Companies Act 2006 and are quite complex. It is the client's responsibility to know whether it meets the small companies regime or not.

<sup>4</sup> The overseas company exemption is set out in section 50 ITEPA.

A permanent establishment includes a fixed place of business which includes a branch, an office or factory, or an agent who habitually exercises authority on behalf of the client. It also includes an oil or gas platform within UK waters.

REC members may send you an exempt company declaration to complete. You do not have to tell the agency that your company is wholly overseas and exempt, but if you don't, they cannot treat you as exempt.

**For more information on the exemption for wholly overseas companies, see:**

- The HMRC Employment Status Manual [ESM 10006, 10025 and 10026](#)

## 2.1.2 Outsourced arrangements

ITEPA does not refer to outsourced arrangements. However, where there is an outsourced arrangement the outsourced services provider will be the client and so will have to apply the off-payroll rules.

**For more information on outsourced arrangements, including some scenarios, see:**

- The HMRC Employment Status Manual [ESM 10010](#)

Agencies should not have to guess whether their client is exempt or not.

As the client, it is your responsibility to know whether you are exempt or not - tell the agency as soon as possible.

This will mean that you, the agency and the contractor all know your respective obligations early on.

## 3 The IR35 status decision

### 3.1 What do I have to do?

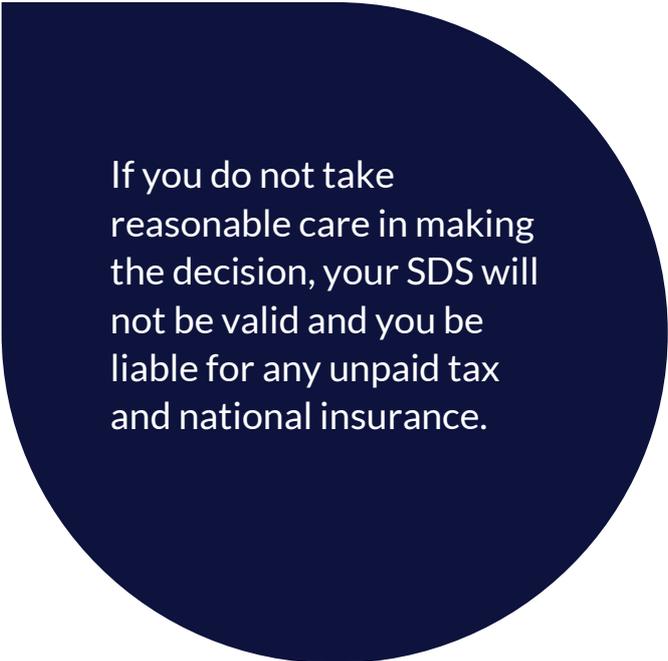
If you are not an exempt client, you must decide whether the engagement is 'inside IR35' or 'outside IR35'. You must use an appropriate assessment process to reach an accurate status decision called a **'status determination statement'** (SDS).

HMRC have built an online tool called ['Check employment status for tax'](#) (CEST). This has been heavily criticised and they have been working to enhance it. HMRC have said that they will stand by CEST outcomes provided the information used in the tool is accurate.

Importantly, you do not have to use CEST - you can use any assessment method you wish, but at all times you must use 'reasonable care' (see section 3.2).

For more information on CEST, see:

- The HMRC Employment Status Manual [ESM 11000](#)



If you do not take reasonable care in making the decision, your SDS will not be valid and you be liable for any unpaid tax and national insurance.

### 3.2 Reasonable care

You must take reasonable care when making the IR35 status decision. What is 'reasonable care' will depend on the size of your company and the resources you have. But it will always mean having a proper process in place (even if that means using external support), having the right person make the decision and using up to date and accurate information to make the decision (but note that your staff will not be personally liable for an IR35 status decision). The threshold for a large multi-national organisation will be higher than the threshold for smaller organisations.

#### *What about blanket decisions?*

We need to distinguish between different types of decisions.

- If you make a blanket decision that all PSC engagements are inside IR35, that is not reasonable care.

- Some clients have decided not to allow contractors to work through PSCs anymore - though that might seem unreasonable to the contractors, that decision means that the off-payroll rules won't apply at all (because there isn't an intermediary which the contractor has a material interest in (see section 1.1)). So, in this case it is irrelevant whether you took reasonable care in making that decision or not. Of course, this will cause some upset with your contractors so prepare for fallout from such a decision.
- Categorising roles into different groups and then making a status decision is also an option - at [ESM 10014](#) HMRC state:

*It is acceptable for a client to make a determination for a group of workers, providing those workers are engaged under the same contractual terms and conditions, and in practice work under the same terms and conditions. However, if determinations are made for groups of workers where the terms and conditions are not the same, this would not be taking reasonable care. If the client has not taken reasonable care then responsibility for the deduction of tax, NICs and apprenticeship levy and paying these to HMRC is the client's. This is the case even if another party has already made deductions in line with the original determination.*

For more information on 'reasonable care', see:

- The HMRC Employment Status Manual [ESM 10014](#)

You can outsource the decision-making process, but you remain legally responsible for the IR35 status decision.

### 3.3 Passing status decisions through the supply chain

Once you make the IR35 status decision, you must pass that decision, together with the reasons for that decision i.e. your SDS, to both the party you contract with (usually the agency) and the contractor (even though you do not have a direct contract with the contractor). Each party must pass the decision down the chain until it reaches the fee-payer, i.e. the party next to the PSC in the supply chain.

#### Diagram: Flow of information through the labour supply chain

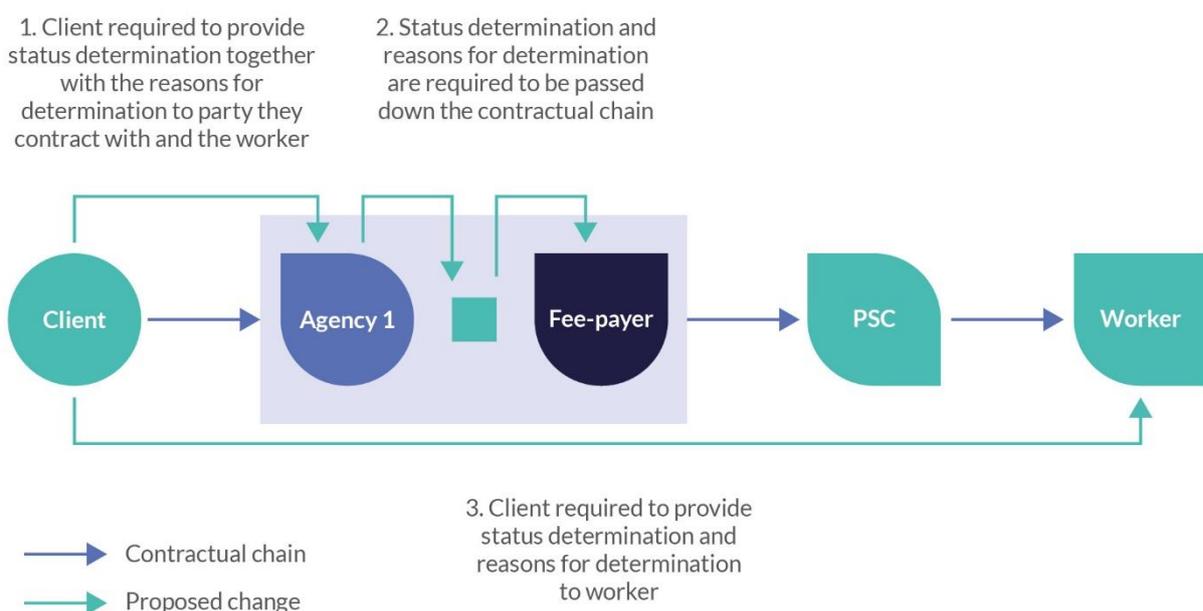


Diagram adapted from the [government's Summary of Responses](#).

### 3.4 Resolving disagreements over status

Contractors and agencies will not always agree with your IR35 status decision (though really only when you decide the engagement is inside IR35). They can ask you to look again at your decision. You must set up a status disagreement process to help resolve disagreements about the status decision reached. You must respond within 45 days of receiving a query and must:

- confirm that you have considered the representations made and decided that your SDS is correct, and give the reasons for that decision; or
- give a new SDS containing a different conclusion, give the date from when the new SDS applies and state that the previous SDS is withdrawn.

If you do not respond within 45 days, you will become the fee-payer and so will have to deduct PAYE tax and NICs and report this through Real Time Information.

## 4 Liability

### 4.1 Liability and the status decision

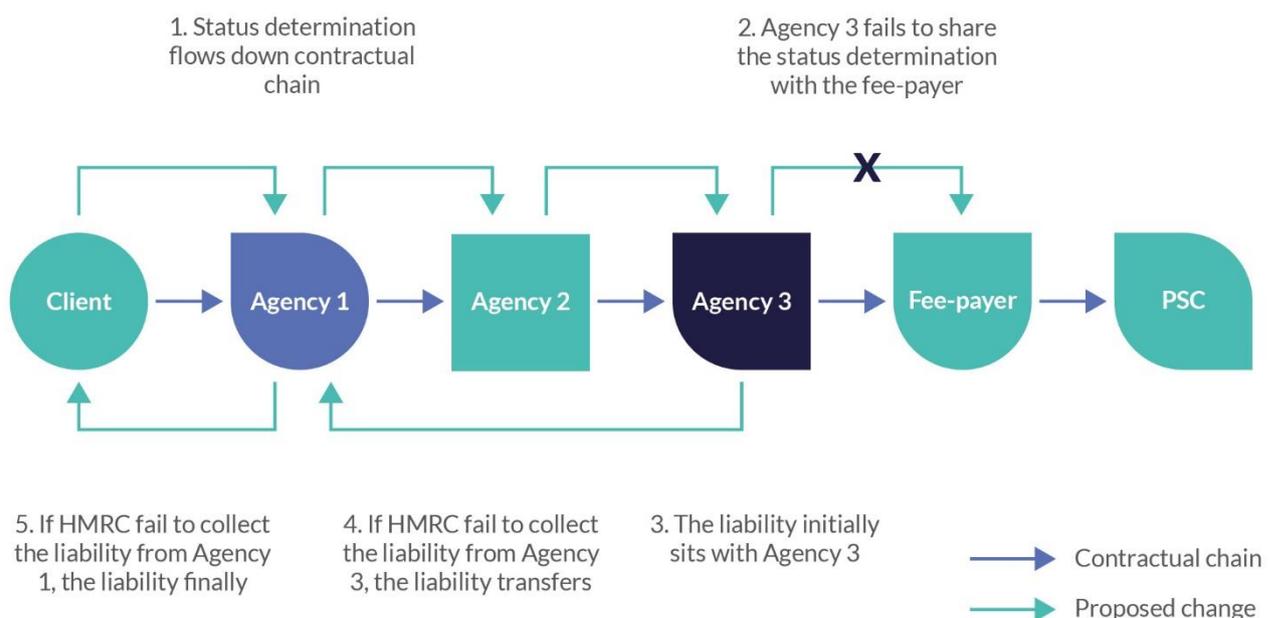
A party's liability for unpaid tax and NICs will depend on whether it is the client, agency or fee-payer. It will also depend on whether that party has done what it needs to do, e.g. you will be deemed to be the fee-payer:

- Until you pass the SDS to the next party in the chain and the off-payroll worker (see section 3.3).
- If you do not withdraw an SDS if you become a small company and therefore exempt (see section 2.1.1).
- If you do not respond to representations about a status decision within 45 days of receiving those representations (see section 3.4).

### 4.2 Transferring liability between different parts of the supply chain

The fee-payer must deduct tax and national insurance before it pays the PSC. If it doesn't, HMRC will look to recover the unpaid tax and NICs from the next party in the supply chain. Importantly, where the fee-payer is off-shore, the fee-payer's responsibilities move up the supply chain to the next UK based entity. We have adapted the following diagram from the [government's Summary of Responses](#).

#### Diagram: Transfer of liability across the labour supply chain



Though we are still waiting for the final regulations on liability HMRC have some guidance about when they will look to recover unpaid tax and NICs and from whom:

*HMRC will not seek to recover from other persons where:*

- *the failure to account for tax and NICs by the person who should initially have paid it is as a result of a genuine business failure on the part of that person; and*
- *the person who should have initially paid it has not knowingly benefitted as a result of winding up without paying the tax liability.*

*HMRC may recover from other persons in circumstances including, but not limited to:*

- *where a promoter of tax avoidance or any other party has entered into the labour supply chain, or other similar contrived situations where the intention is to avoid the tax and NICs liabilities that would rest with the person who should have paid those liabilities;*
- *where a client or agency 1 in the chain requires workers to provide their services by contracting through a particular party that is likely to have been chosen due to its non-compliance with the off-payroll working rules;*
- *where a fee-payer/deemed employer liquidates where the intention of liquidation was to avoid the income tax and NICs liability due from application of the off-payroll working rules;*
- *Where a client or agency 1 in the chain knew, should have known or had reasonable grounds to suspect that the labour being supplied to them was supplied through a party or parties in the labour supply chain that did not comply, or had no intention of complying with the rules.*

**For more information on the transfer of liability, see:**

- The HMRC Employment Status Manual [ESM 10031](#)

If HMRC cannot collect tax and NICs from the fee-payer, liability can be transferred up the supply chain.

## 5 Contracts and indemnities

### 5.1 Contracts

The REC has prepared different contracts for agencies to use depending on whether their clients are exempt or not. They will also want to put in place contracts with outside IR35 contractors as soon as possible. They will have to change contracts for those contractors who are inside IR35 and may do this close to 6 April 2021. They will need your help to manage this particularly where there are large numbers of contractors.

As the rules will apply to payments made for work done on or after 6 April 2021, agencies may want to clearly separate work done up to and including 5 April 2021 from work done after that date. They may also want to do more than one pay run in a given period to help contractors. It would help agencies if you agree to an additional invoice and payment in April 2021 to help them manage this transition.

### 5.2 Statements of work

Agencies, clients and contractors are all interested in statements of work contracts to manage the off-payroll rule changes. However recruitment services are very different to say delivering a full IT service. The responsibilities and liabilities for non-delivery will be different, payment may be on completion of certain phases of the work leading to cashflow issues for the agency and insurance needs will be different. Statements of work are not a silver bullet to the off-payroll changes - the REC advises agencies to take great care before signing up to statement of work contracts. Simply relabelling a contract as a 'statement of work' will not work either.



Do not simply relabel a contract as a 'statement of work' contract. HMRC will assume it is a recruitment service, until the agency and client prove otherwise.

### 5.3 Indemnities

We understand that clients want to protect themselves as much as possible from tax matters relating to their contractors. But agencies also want to protect themselves. The REC advises agencies not to give indemnities which protect clients regarding their own legal obligations, particularly where the agency has no control over how you manage those obligations. If you insist on such an indemnity, the agency may have to charge you more to cover the increased insurance premium (if the agency can insure against the indemnity in the first place).

## 6 Additional costs

### 6.1 Employers' national insurance

When you decide that an engagement is inside IR35, the agency will have to pay employers' NICs on the contractor's pay. Agencies will want to negotiate with you to decide how this will be covered, whether in existing charge and pay rates or whether there will be an increase in rates.

### 6.2 Apprenticeship levy

Agencies (and umbrella companies) who bring inside IR35 contractors onto payroll will see their apprenticeship levy bill increase. The agency will want to negotiate an increased charge rate to cover this additional cost.

## 7 Top tips

1.	Assess whether your business will be exempt from the off-payroll rules or not. Tell your agencies as early as possible if you are exempt or not. If you are close to the thresholds, keep your status under review.
2.	Assess which contractors might be affected by the changes and why.
3.	Identify who within your business can make IR35 status decisions and ensure that those individuals understand how to assess status and have the appropriate tools to do so. Consider if you need to engage a well-established external reviewer to help with your IR35 status decisions.  Periodically review your status decisions and tell agencies immediately if you decide to change an earlier status decision.
4.	Put processes in place to pass the status decision and the reasons for that decision, to the contractor and the agency.
5.	Work with agencies who will have their own processes in place to implement.
6.	Agree with agencies how the increased employer costs will be met - agencies will not be able to simply absorb these costs and pay contractors the same rates.



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