



Recruitment
& Employment
Confederation

The Off-Payroll Rules

Factsheet for contractors

Extension of the Off-Payroll Rules to the private sector

factsheet for contractors

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

- The REC has written this factsheet for REC members to share with their contractors in preparation for the IR35 reforms due in April 2021. This guide is not specific legal advice for contractors, and you must get your own legal advice.
- We include [hyperlinks](#) to relevant sources.
- The information contained in this document, all hyperlinks and figures are correct at the time of writing.

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1 A recap of IR35

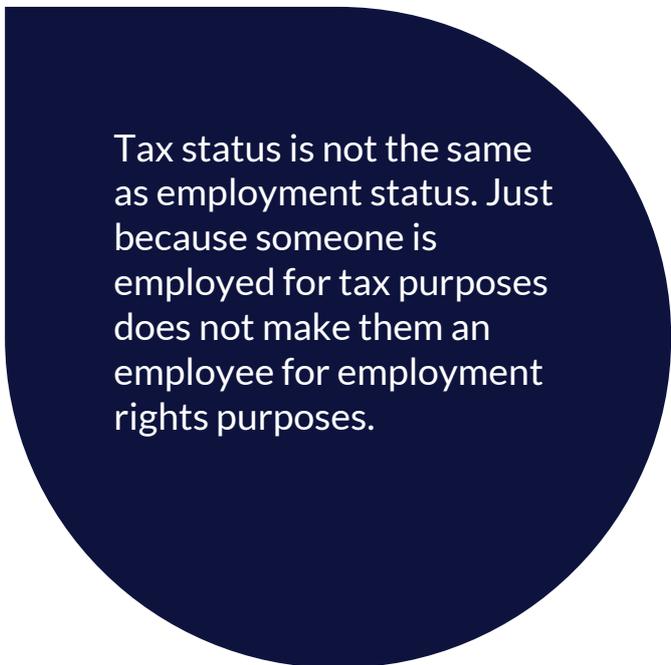
1.1 What does 'IR35' mean?

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

The IR35 rules provide that if the PSC did not exist, but you, the contractor, looked like an employee of the client for tax purposes, then the assignment is deemed to be 'inside IR35'. That means that your pay should be subject to PAYE tax and employees' national insurance contributions (NICs). Employers' national insurance will also be due. If the assignment is outside IR35, then PAYE tax and employee and employer NICs are not due but corporation and other taxes may 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 ease we will use the terms 'PSC' and 'contractor' in this guide. We also use the terms 'IR35' and 'off-payroll' rules interchangeably.



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.

¹ 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.

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, usually an agency).

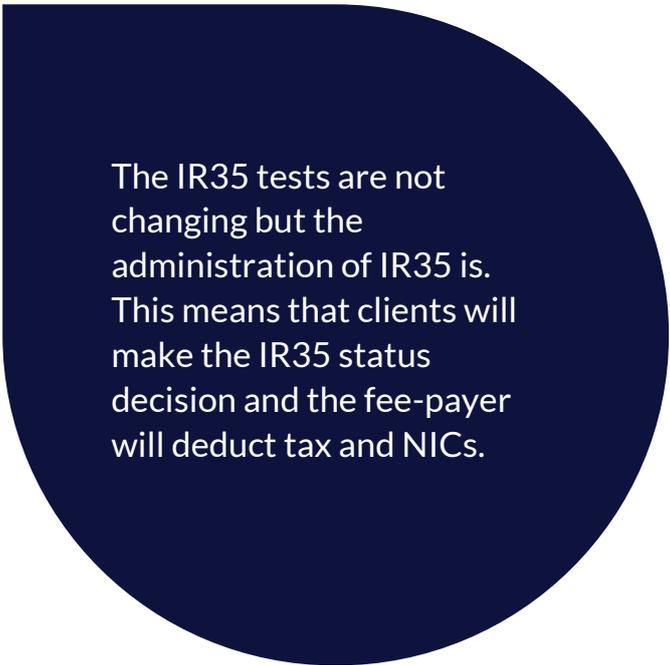
At the moment, when you provide your services to a private sector client, your PSC is responsible for IR35. However, that will change from 6 April 2021 when the off-payroll rules are extended into the private sector.

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

2.1 Which clients will be affected?

The off-payroll rules will apply to all public authorities, and private sector clients that are not exempt (see section 2.1.1). So, agencies will have to know if their clients are exempt or not. And clients will have to know how their temporary workers are engaged and by whom, e.g. whether PAYE'd by an agency or an umbrella company, or through a PSC. Importantly, the rules will also apply where clients engage contractors directly rather than through an agency (here the client is both the client and the fee-payer).

Where the off-payroll rules apply, **the client must assess the contractor's status for tax purposes**. So which clients will the off-payroll rules apply to and what will the client need to do?



The IR35 tests are not changing but the administration of IR35 is. This means that clients will make the IR35 status decision and the fee-payer will deduct tax and NICs.

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 ²:

- 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.

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

Overseas companies with no UK connection will also be exempt. 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.

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.

Even if you live overseas, that does not mean that the off-payroll rules do not apply. It is the client's status that counts.

2.1.2 Outsourced arrangements

Where there is an outsourced arrangement the outsourced services provider will be the client and so will have to apply the off-payroll rules.



If a client is exempt, the existing IR35 rules apply so the PSC will continue to be responsible for applying the rules and making relevant deductions.

² The small companies' exemption is set out in Section 50 ITEPA. The small company criteria are set out in Section 383 Companies Act 2006.

2.1.3 Statements of work

Agencies, clients, and contractors are all interested in statements of work contracts as a possible way to manage the off-payroll rule changes. However recruitment services are very different to say, 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. Also, agencies cannot just relabel a contract as a 'statement of work' if that is not the case. HMRC will be alert to this and will assume an agency is delivering a recruitment service and not a statement of work contract, until proven otherwise.

2.2 What agencies and clients need from you

To assess which contractors may be affected, agencies and clients will have to ask you questions about your ownership and management of whichever intermediary you work through. Specifically, they need to know if you have a 'material interest' in the intermediary, i.e. do you own more than 5% of the shares in the company or are you entitled to 60% or more of the profits of a partnership? They will also ask questions about how many other clients you may have, if you intend to use substitutes to provide the services and what insurances you hold. The agency will ask for your VAT number. They may ask you to complete a due diligence checklist. All of this is to establish that you are genuinely in business on your own account, which is what IR35 is all about.



Agencies and clients have to know if you are genuinely running a business - they will ask questions about ownership and management of your PSC.

3 The client's tax status decision

3.1.1 What does the client have to do?

The client must decide whether the engagement is 'inside IR35' or 'outside IR35' - it must use an appropriate assessment process to get 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 criticised quite heavily 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.

3.1.2 Reasonable care

Clients do not have to use CEST - they can use any assessment method they wish, but they must always take reasonable care when making its status decision. What is 'reasonable care' will depend on the size of the client and the resources it has. But the client must have a suitable process in place even if that means using external support.

- Some clients have decided not to allow contractors to work through PSCs anymore - though that might seem unreasonable to you, 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). So, it is irrelevant whether the client took reasonable care in making that decision or not.
- If a client makes a blanket decision that all PSC engagements are inside IR35, that is not reasonable care.
- Alternatively, some clients might categorise roles into different groups which is fine if they follow HMRC's guidance.

A client can outsource the decision-making process, but it remains legally responsible for the decision.

3.1.3 Contractual terms - substitution

CEST and other tools, will ask whether you can send a substitute to provide the services in your place. Having a substitution clause in your contract will not automatically mean that the engagement is outside IR35. Some clients will allow substitutes, others will only allow substitution if they pre-approve the substitute. Some clients cannot allow substitution because of security or safeguarding issues. Ultimately, IR35 status is determined by a number of factors and not substitution alone - HMRC will look at the reality of the engagement and determine status accordingly.

3.1.4 Passing status decisions through the supply chain

Having made the tax status decision, the client must pass that decision, and the reasons for that decision, to both the party they contract with (usually the agency) and to you the contractor (including where the client does not have a direct contract with you). Each party must pass the decision down the chain until it reaches the fee-payer, i.e. the party next to the intermediary in the supply chain.

Diagram: Flow of information through the labour supply chain

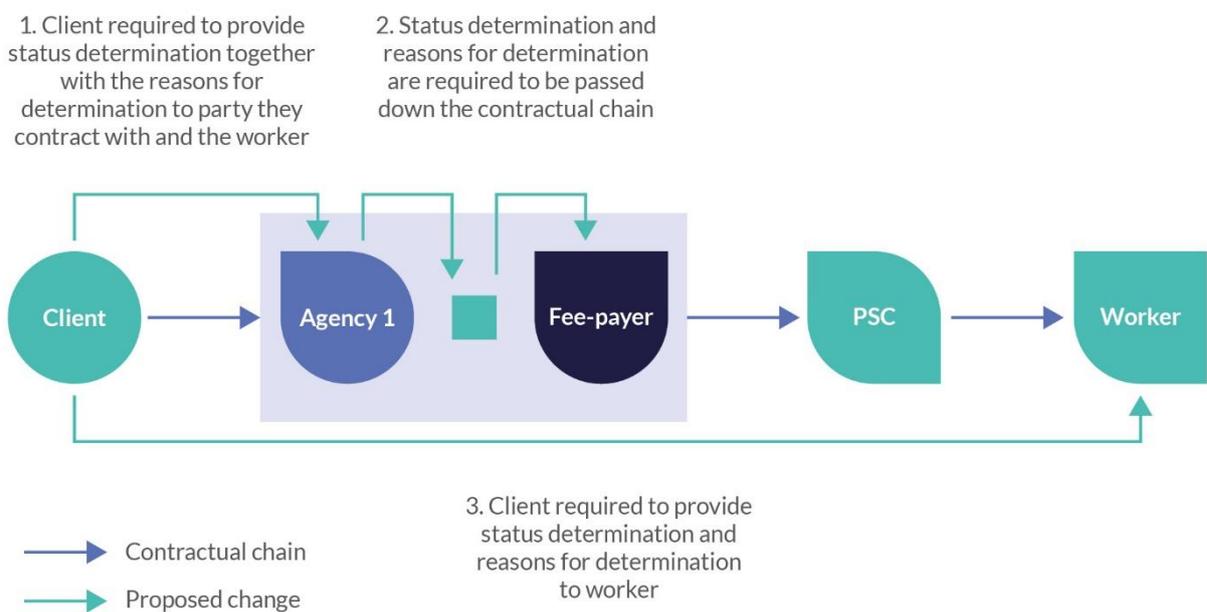


Diagram adapted from the [government's Summary of Responses](#).

3.1.5 Resolving disagreements over status

You may not agree with the client's IR35 status decision, but you can ask it to look again at its decision. The client must set up a status disagreement process to help resolve disagreements about the status decision reached. The client must respond within 45 days of receiving a query and must:

- (a) confirm that it has considered the representations made and decided that its SDS is correct, and give the reasons for that decision; or
- (b) give a new SDS containing a different conclusion and state that the previous SDS is withdrawn.

If the client does not respond within 45 days, it will become the fee-payer which means for inside IR35 engagements, it must deduct PAYE and employee NICs before paying your PSC.



Even if you disagree with the client's IR35 status decision, the agency cannot ignore a client's inside IR35 decision. If it does, it will be responsible for the unpaid tax and NICs.

4 Paying the PSC

4.1.1 What does the fee-payer/agency have to do?

If the client decides that an engagement is inside IR35 the fee-payer must (a) calculate the 'deemed direct payment' due to your PSC, and then (b) deduct PAYE tax and NICs from that payment. It must also pay employer's NICs.

If the client decides that the engagement is outside IR35 then the fee-payer can pay the PSC gross and the PSC will manage its own tax affairs.

4.1.2 How to calculate the deemed direct payment

The rules specify how the fee-payer must make deductions before paying your PSC.

Step 1 – identify the gross sum claimed by the PSC (i.e. by invoice). Disregard VAT for the time being.

Step 2 – deduct the direct cost of any materials used in the provision of the individual's services.

Step 3 – deduct any expenses that would have been deductible from the individual's taxable earnings if (a) the individual had been employed by the client and (b) had met those expenses out of those earnings.

Step 4 – the balance is the deemed direct payment. If nil, or negative, there is no deemed direct payment. Add back any VAT disregarded at Step 1 and make payment.

The balance from Step 4 is the sum which is subject to PAYE tax and NICs and on which employers' NICs are calculated (subject to any thresholds).

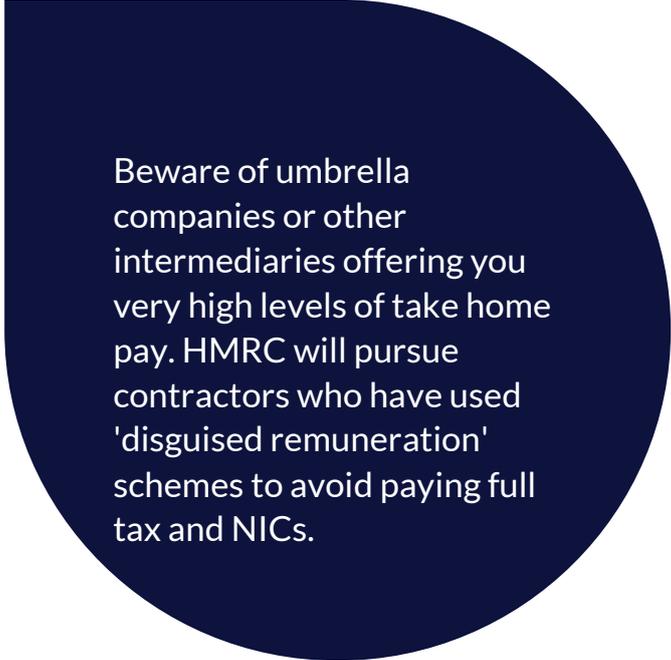
Note that the fee-payer will not make deductions for holiday pay or pensions as those remain the responsibility of your PSC.

The fee-payer will need your PAYE tax code and national insurance number. If the fee-payer does not have an up to date tax code for you, it will have to apply emergency tax.

4.1.3 Moving from PSC to agency payroll or umbrella

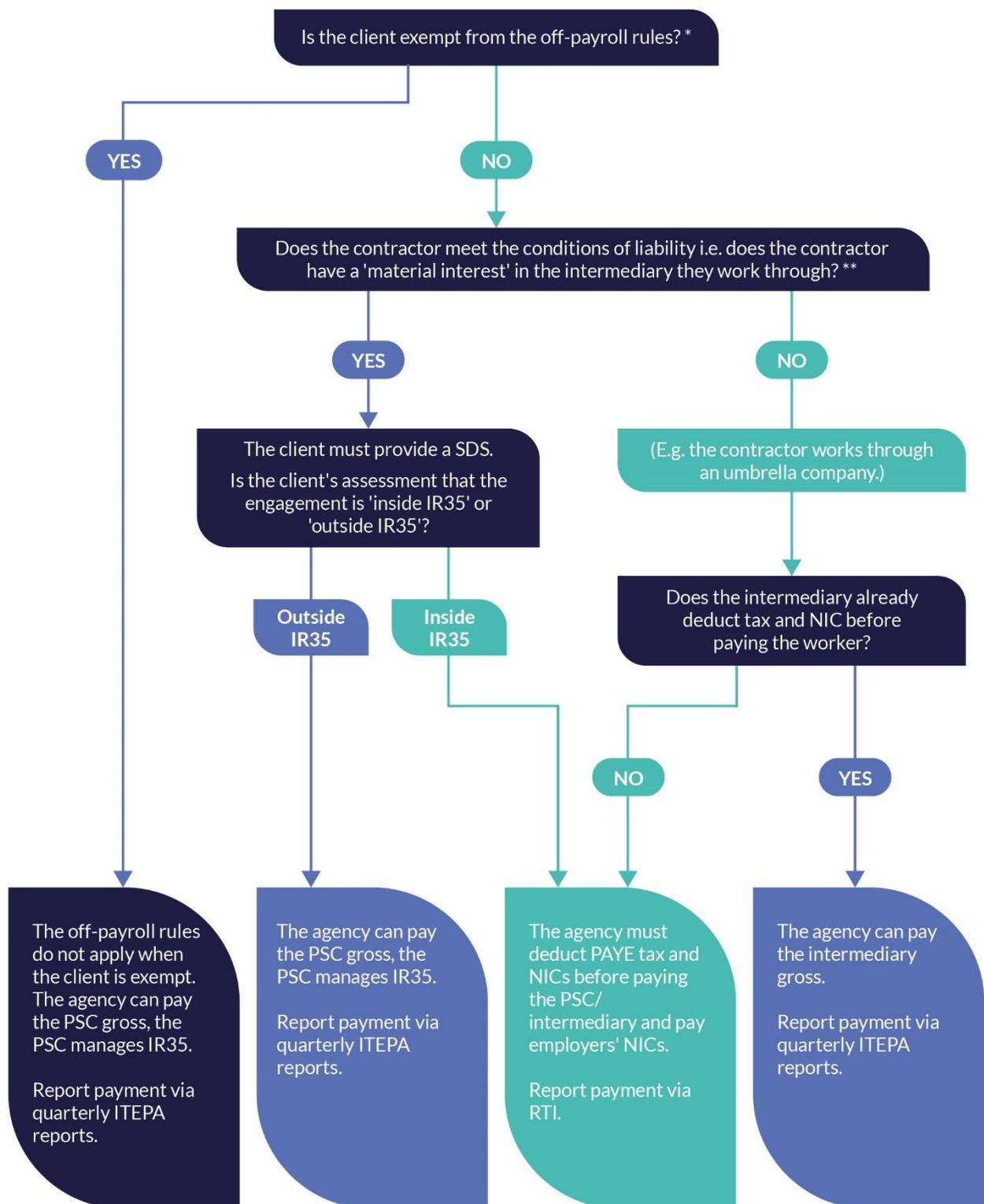
When your engagement is inside IR35, you may decide with the agency that it is more efficient to work on a contract for services with the agency (and be payrolled directly by the agency) rather than through your PSC. Or you may think about working through an umbrella company. The agency has to know that any umbrella company will deduct the correct tax and NICs and comply with all other legislation. The REC advises agencies to do proper due diligence and to have a list of umbrellas they are happy to work with.

Some umbrella companies and intermediaries will offer you very high levels of pay e.g. 80% or more. They may offer agencies or you, a legal opinion which tells you that a particular scheme complies with the law. They may encourage you to work through an intermediary based overseas. However such schemes are highly risky for both you and the agency. See [HMRC Spotlights](#) for information on disguised remuneration schemes to avoid.



Beware of umbrella companies or other intermediaries offering you very high levels of take home pay. HMRC will pursue contractors who have used 'disguised remuneration' schemes to avoid paying full tax and NICs.

Flowchart - Does the agency have to deduct tax and NICs?



*Section 2.1.1

**Section 1.1

5 Contracts, other deductions and worker rights

5.1 Contracts

Agencies have a lot to do to implement the off-payroll rules. When a client confirms that an engagement is outside IR35 they will give you an outside IR35 contract as soon as possible. When the client confirms that it is an inside IR35 engagement they will need to change their contract with you. The off-payroll rules will apply to payments made for work done on or after 6 April 2021 so agencies will want to separate work done up to and including 5 April from work done on or after 6 April. Help your agency to help you by sending them invoices separating out this work when requested.

5.2 Employers' national insurance and apprenticeship levy

When the client decides that an engagement is inside IR35, the fee-payer must also pay employers' national insurance. They may also have to pay the apprenticeship levy.

If the client does not increase the rate, they pay to the agency to cover these costs, the agency will have to reduce your pay rate to account for them. The agency should terminate your previous assignment (if you have been working for this client) and give you a new inside IR35 contract with a new pay rate (assuming you continue to work through your PSC and do not go onto the agency's payroll or that of an umbrella company).

Since 6 April 2020 agencies have had to provide a Key Information Document (KID) to all work-seekers before they agree terms. In particular this includes detailed information about pay and deductions.

5.3 Employment status and worker rights

Being employed for tax purposes is not the same as being employed for employment rights purposes. It does not automatically follow that because you pay PAYE and NICs, you are entitled to worker rights such as sick pay, holiday pay or pensions auto-enrolment. The government has agreed to look at closer alignment of status for tax and employment rights purposes but haven't given a timeframe for that. So, for the moment your entitlement to worker rights will depend on how you are engaged:

- If you continue to work through your PSC, the PSC will still be responsible for any worker rights, including holiday pay and sick pay.
- If an agency engages you directly on a contract for services, the agency will be responsible for your worker rights.
- If you work through an umbrella company, the umbrella will be responsible for your worker rights. If you and the agency decide it is better for you to work through an umbrella company the agency may have an approved list of umbrella companies for you to choose from.



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