

# Off-payroll working in the public sector

Opinion piece by Mark Morton, Head of Tax

## Introduction

It is many years since the IR35 legislation was introduced and yet the issues which that legislation attempted to address have still not been given the coup de grace.

In the latest attempt by the Government to crack down on 'false self-employment', from April 2017 individuals working through their own company in the public sector are no longer responsible for deciding whether the intermediaries' legislation applies but rather the public sector employer, agency, or third party that pays the worker's intermediary is responsible. The employer, agency or third party have to decide if the rules apply to a contract and, if so, account for and pay the liabilities through RTI and deduct the relevant tax and NIC.

The new rules apply to the provision of services to a public authority through an intermediary and apply to deemed direct payments treated as made on or after 6 April 2017, even if relating to services provided before that date.

Generally, 'public authority' means organisations that are Public Authorities for the purposes of the Freedom of Information Act 2000 and Freedom of Information Act (Scotland) 2002 and includes Government departments, legislative bodies, the armed forces, local government, the NHS, schools, the police and the

BBC. An authority under the two Acts above is a public authority for the purposes of these rules in relation to all its activities,

even if provisions of those Acts do not apply to all information held by the authority.

Retail pharmacists and opticians which provide NHS services are not within this definition. HMRC state:

**'The definition of "public authority" continues to include general practitioner surgeries and dental practices or surgeries providing NHS medical and dental services. This means these public authorities are required to consider whether the off-payroll working in the public sector rules should be applied to contractors working for them through an intermediary.'**

## Conditions of liability

The new rules apply where:

- an individual (the worker) personally performs, or is under an obligation personally to perform, services for another person (the client);
- the client is a public authority;
- the services are provided not under a contract directly between the client and the worker but under arrangements involving a third party (the intermediary); and
- the circumstances are such that if the services were provided under a contract directly between the client and the worker, the worker would be regarded as an employee or office-holder of the client or the worker is an office-holder who holds that office under the client and the services relate to the office.

A 'third party' includes a partnership or unincorporated association of which the worker is a member. Holding office as statutory auditor does not count as holding an office!

## Worker treated as receiving earnings from employment

If one of Conditions A to C is met, there is a requirement to identify the chain of two or more persons where the highest person in the chain is the client, the lowest person in the chain is the intermediary and each person in the chain above the lowest



makes a chain payment to the person immediately below them in the chain. The following definitions are used:

- a 'chain payment' means a payment, or money's worth or any other benefit, that can reasonably be taken to be for the worker's services to the client;
- 'make' in relation to a chain payment that is money's worth means transfer and, in relation to a chain payment that is a benefit other than a payment or money's worth, means provide; and
- 'the 'fee-payer' means the person in the chain immediately above the lowest.

The fee-payer is treated as making a payment to the worker which is to be treated as earnings (the deemed direct payment) but this is subject to special situations involving non-resident fee-payers.

The deemed direct payment is treated as made at the same time as the chain payment made by the fee-payer.

Condition A is that the intermediary is a company and the conditions in s61O ITEPA 2003 are met in relation to the intermediary.

Condition B is that the intermediary is a partnership, the worker is a member of the partnership, the provision of the services is by the worker as a member of the partnership and the condition in s61P ITEPA 2003 is met in relation to the intermediary.

Condition C is that the intermediary is an individual.

## Conditions where the intermediary is a company

A company is treated as an intermediary if it is not an associated company of the client and the worker has a material interest in the intermediary.

A company is an associated company of the client if it is such a company by reason of the intermediary and the client being under the control of the worker or of the worker and other persons.

The worker is treated as having a material interest in the intermediary if the worker, alone or with one or more associates of the worker, or an associate of the worker, with or without other associates of the worker, has a material interest in the intermediary.

A 'material interest' broadly means the ability to control (together with 'associates') more than 5% of the company.

An 'associated company' has the meaning given by s449 CTA 2010.

## Conditions where the intermediary is a partnership

A partnership is treated as an intermediary if:

- the worker, alone or with one or more relatives, is entitled to 60% or more of the profits of the partnership;
- most of the profits of the partnership derive from the provision of services under engagements to which one or other of this Chapter and Chapter 8 (IR35) ITEPA 2003 applies to a single client, or to a single client together with associates of that client; or
- under the profit sharing arrangements the income of any of the partners is based on the amount of income generated by that partner by the provision of services under engagements to which one or other of this Chapter and Chapter 8 (IR35) ITEPA 2003 applies.

'Relative' means spouse or civil partner, parent or child or remoter relation in the direct line, or brother or sister.

## The deemed direct payment

Where the new rules apply the deemed direct payment is calculated using the following four steps:

**Step 1** - Identify the gross amount or value of the chain payment made by the person who is treated as making the deemed direct payment and deduct from it any VAT.

**Step 2** - Deduct any amount which represents the direct cost to any person of materials used, or to be used, in the performance of the services.

**Step 3** - Deduct, at the option of the person treated as making the deemed direct payment, so much of that amount as represents expenses met by the intermediary that would have been deductible from the taxable earnings from the employment if the worker had been employed by the client and the expenses had been met by the worker out of those earnings.

**Step 4** - Any remaining positive figure is the deemed direct payment.

The reference above to expenses met by the intermediary includes expenses met by the worker and reimbursed by the intermediary and, where the intermediary is a partnership and the worker is a member of the partnership, expenses met by the worker for and on behalf of the partnership.

If the actual amount or value of the chain payment is such that its recipient bears the PAYE or NIC in respect of the deemed direct payment, Step 1 applies as if the amount or value of that chain payment were what it would be if the burden of that cost were not being passed on through the setting of the level of the payment.

# Application of the income tax Acts in relation to deemed employment

The tax and PAYE rules apply as if the worker were employed by the person treated as making the deemed direct payment and the services were performed, or to be performed, by the worker in the course of performing the duties of that employment.

The deemed direct payment is treated as taxable earnings from the employment for the purpose of claiming any employment-related deductions but such expenses cannot exceed the deemed direct payment.

It has been reported that some agencies, as the paying entity, are also deducting employers' NIC from the payments which they make to the workers' companies. It should be noted that there is no basis in the legislation for this to be done – it is a change of commercial terms.

The worker is not chargeable to tax in respect of the deemed direct payment if, or to the extent that, by reason of any combination of the following factors the worker would not be chargeable to tax if the client employed the worker, the worker performed the services in the course of that employment and the deemed direct payment were a payment by the client of earnings from that employment. The factors are:

- the worker being resident or domiciled outside the UK or meeting the requirement of s26A ITEPA 2003 (foreign earnings and remittance basis);
- the client being resident outside, or not resident in, the UK; and
- the services being provided outside the UK.

Where the intermediary is a partnership or unincorporated association, the deemed direct payment is treated as received by the worker in the worker's personal capacity and not as income of the partnership or association.

Where the client is the person treated as making the deemed direct payment, the worker is resident in the UK, the services are provided in the UK, the client is not resident in UK and the client does not have a place of business in the UK, the client is treated as resident in the UK.

## Information to be provided by clients and consequences of failure

Where the conditions of liability are met and a person as part of those arrangements enters into a contract with the client, the

client must inform that person (in the contract or otherwise) that the worker either will or will not be deemed to be an employee/office-holder.

If the contract is entered into on or after 6 April 2017, this duty must be complied with on or before the time of entry into the contract or, if the services begin to be performed at a later time, before that later time.

If the contract is entered into before 6 April 2017, this duty must be complied with on or before the date of the first payment made under the contract on or after 6 April 2017.

If this information has been given, the client must, on a written request by the person, provide the person with a written response to any questions raised by the person about the client's reasons for reaching the conclusion identified in the information.

A response must be given within 31 days beginning with the day the request for it is received by the client.

If the client fails to comply with the above or exercise reasonable care in deciding on the status issue, the client and not the fee-payer is treated as the payer of the direct deemed payment.

The law envisages that the public sector organisation should have considered each individual contract on an individual basis and make a judgement whether the 'status' tests are failed. To help in this process HMRC updated their [online tool](#).

What is clear in the real world is that public sector organisations have not made individual judgements on individual contracts but, rather, adopted a blanket 'you're caught' approach for self-preservation. Unfortunately for the workers concerned, there is no right of appeal. One option is that the workers can run the tool themselves and, if it indicates self-employment, insist that the public sector address this. Another option is to ultimately self-assess on the basis that the rules do not apply and claim a repayment, although HMRC's reaction will be interesting!

## Prevention of a double charge to tax and the allowance of certain deductions

Where a person:

- receives a payment or benefit ('the end-of-line remuneration') from another person ('the paying intermediary');
- the end-of-line remuneration can reasonably be taken to represent remuneration for services of the payee to a public authority;
- a payment ('the deemed payment') has been treated as made to the payee;
- the underlying chain payment can reasonably be taken to be for the same services of the payee to that public authority; and



- the recipient of the underlying chain payment has borne the cost of any PAYE and NIC in respect of the deemed payment
- then the paying intermediary may treat the amount of the end-of-line remuneration as reduced (but not below nil) by any one or more of the following:
  - the amount of the deemed payment;
  - the amount of any capital allowances in respect of expenditure incurred by the paying intermediary that could have been deducted from employment income under s262 CAA 2001 if the payee had been employed by the public authority and had incurred the expenditure; and
  - the amount of any contributions made, in the same tax year as the end-of-line payment, for the benefit of the payee by the paying intermediary to a registered pension scheme that, if made by an employer for the benefit of an employee, would not be chargeable to income tax as income of the employee. This does not apply to excess contributions paid and later repaid, contributions set against another payment by the paying intermediary or contributions deductible at Step 5 s54(1) ITEPA 2003 in calculating the amount of a deemed payment under the normal IR35 rules.

The 'underlying chain payment' means the chain payment whose amount is used at Step 1 of s61Q(1) ITEPA 2003 as the starting point for calculating the amount of the deemed payment.

The above rules apply whether the end-of-line payment is earnings of the payee, a distribution of the paying intermediary or takes some other form. What these rules are catering for is the ultimate extraction of cash from the workers' intermediaries. This must be done in the normal manner, either as pay (with tax already suffered), dividend, employer pension contribution, etc. To the extent that these monies do not exceed the net deemed payment no further tax is due. However, the pay issue is important as to establish state benefit entitlement payments the lower earnings limit will need to be triggered.

## Trade deduction

Where the person is the intermediary, a deemed direct payment is treated as made and the person receives a payment which can reasonably be taken to be in respect of the same services as those in respect of which the underlying chain payment is made, the deemed direct payment is not required to be brought into account in calculating the profits of the trade. This point is important to note as in order to have the deemed payment excluded from taxable income of the intermediary it appears the worker has to extract the cash (net deemed payment). Not doing so would leave the worker in the invidious position of having suffered PAYE at source and tax on intermediary profit, the worst of both worlds.

## Conclusion

The rules are not operating as the Government intended but close attention needs to be paid to the detail of the legislation to ensure no unexpected surprises.

### About the author



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