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New tax rules for individuals working via their own companies for a medium or large business

From 6 April 2020, new tax rules are proposed for individuals who provide their personal services via an ‘intermediary’ to a medium or large business. An intermediary may be another individual, a partnership, an unincorporated association or a company. The most common structure is a worker providing their services via their own company (PSC) which is the term used in this letter to summarise the rules which will apply to all intermediaries.

Similar rules were introduced in 2017 for public sector organisations receiving services from PSCs. The 2020 rules will use the 2017 rules as a starting point which means, in practical terms, that the principles have already been decided but some aspects of the detailed operation of the rules will be decided in a consultation process. The intention is that draft legislation will be published this summer.

The effect of these rules, if they apply to you, will mean:

- the medium or large business (or an agency paying the PSC) will calculate a ‘deemed payment’ based on the fees the PSC has charged for the services of the individual
- generally, the entity that pays the PSC for the services must first deduct PAYE and employee National Insurance contributions (NICs) as if the deemed payment is a salary paid to an employee
- the paying entity will have to pay to HMRC not only the PAYE and NICs deducted from the deemed payment but also employer NICs on the deemed payment
- the net amount received by the PSC can be passed onto the individual without paying any further PAYE and NICs.

The practical effect of these rules is that you will no longer benefit from the potential tax advantages of receiving such income via your own company.

There may also be pressure from businesses to renegotiate contracts due to their increased cost of employer NICs.

The new tax rules apply to amounts paid from 6 April 2020 and so may affect current contracts.

What is a medium or large business?

This has not yet been decided but the government intends to use an existing statutory definition with the Companies Act of a 'small company' to exempt small businesses from the new rules. Therefore the rules will probably exempt businesses meeting any two of these criteria: a turnover of £10.2 million or less; having £5.1 million on the balance sheet or less; having 50 or fewer employees. If the business receiving the work of the individual is not a company, the test will only look at the turnover and number of employees criteria and may only require one of these to be met.

Who will decide if the rules apply?

The medium or large business will decide. The business needs to form an opinion as to whether, if the personal services of the individual were provided under a contract directly between the individual and themselves, the individual would be regarded as an employee of the business. This is the same kind of employment status test based on case law that businesses and agencies have to consider when they hire staff directly.

It is a matter of judgement whether the nature of and manner in which the services provided point to employment or self-employment. HMRC has a Check Employment Status Service tool (CEST) to help businesses decide the status of individuals providing personal services to them. HMRC is currently working 'to identify improvements to CEST and wider guidance to ensure it meets the needs of the private sector'.

For reasons which are explained below, the business may be tempted to err on the side of employment particularly if CEST indicates employment.

The link to the Employment Status Service tool is www.gov.uk/guidance/check-employment-status-for-tax.

Why have these rules been introduced?

The 2020 rules will replicate many of the effects of the 'intermediaries' legislation enacted many years ago (often called the IR35 rules). This legislation requires, for example, a one person company to judge whether the IR35 rules apply. If IR35 applies the PSC would then treat the relevant fees received by the company as deemed payments to the worker and thus account for PAYE and NICs.

HMRC have found it difficult to enforce their view of the applicability of the IR35 legislation to many PSCs. Many view the risk of being 'caught' by IR35, and thus being required to pay PAYE and NICs, is outweighed by the benefit of company profits being paid out under a 'low salary, balance as dividends' regime.

The new legislation therefore shifts the responsibility to the business receiving the services of the individual. This means that the risk of non-compliance falls onto the business. If the business decides the new rules do not apply they may have to have a protracted dispute with HMRC which ultimately may go to a Tax Tribunal. If the Tribunal decides against the business, the business will have to pay over PAYE and NICs to HMRC, having already paid the gross fees to the PSC.

What can you do if you disagree with the business deducting PAYE and NICs?

The government is expected to require the medium or large business when it makes a status determination to:

- communicate the decision to the worker, and
- give the reasons for that determination if requested by the worker.

This will be in addition to communicating the decision to the party with whom the business has contracted; for example an agency.

If you disagree with the decision, your first step is to ask for the reasons for the determination. You can use the tool to see if you obtain a different conclusion. If you obtain a result which confirms self-employment you can discuss the results with the business or you can contact us to discuss the matter. Even if you obtain an employment result, this does not necessarily mean the result is correct. HMRC state that the current tool is ‘able to determine employment status in 85% of cases’ which, of course, means it is not correct in 15% of cases. Many commentators consider the accuracy of the tool to be much lower.

HMRC is currently working with stakeholders to enhance the service and guidance on the use of CEST but many commentators consider that the law on status is too complicated for a yes/no checklist to provide the right answer in all cases.

The government is not expected to allow a formal right of appeal to HMRC or the Tax Tribunals in the legislation by you or your company. Instead, there may be a requirement for the medium or large business to have a process to resolve disagreements based on a set of requirements set out in legislation.

What is the tax effect on you?

The important point to appreciate is that you will be treated in tax terms as an employee of the entity that pays the PSC for your services. So if a contract ends during the 2020/21 tax year, the paying entity should send you a P45 showing the total deemed payment and deductions for PAYE and NICs. If the contract extends over the 2020/21 tax year, the paying entity should issue a P60 to you showing the total payment and deductions in the 2020/21 tax year.

You will need to show the amounts on the P45 or P60 as an employment on the employment pages of your 2020/21 self assessment tax return.

The amounts of income tax recorded as paid by you on the P45 or P60 may well not be the correct amount of income tax payable by you. Please look at the first part of the example in the Appendix which illustrates how PAYE and NICs are deducted from the deemed payment by the paying entity.

The other important point to appreciate is that it is your company which is receiving the amounts from the paying entity. How can you extract such income tax efficiently? The proposed legislation will have special rules to allow you to do so.

What procedures does your PSC need to follow if deemed payments are received?

The PSC will deduct the amount of the payment it receives, as well as the PAYE/employee NICs costs incurred, from its taxable income, so it will not be taxed twice.

Please see the second part of the example in the Appendix which illustrates the procedures your PSC will take in passing the net deemed payment to you.

What if your company has other contracts hiring out your personal services?

Nothing is expected to change in respect of contracts your company has with small private sector clients. The possible application of IR35 needs to be considered but there is no change in the law regarding IR35. If contracts are not caught by IR35, we will help you decide on an appropriate profit extraction strategy for the profit from these contracts.

How we can help

We can help you decide whether to discuss the operation of the proposed legislation with the medium or large business.

If you have any queries, please do not hesitate to contact us.

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APPENDIX

Example of potential operation of the off-payroll rules

This is an example of the likely effect of the operation of the rules based on how the rules for the public sector operate.

Derek provides personal services to a large business via his personal services company, Derek Ltd. The business considers the off-payroll working legislation applies. The contract will end on 30 September 2020.

In 2020/21, Derek Ltd invoices the business £4,000 a month. There is no VAT and no expenses in the invoices.

The business would treat each of the monthly payments as deemed payments. Derek will need to provide the business with his National Insurance Number, address, date of birth and P45 if appropriate in order that they can set him up on their payroll.

As Derek has a 'primary employment' with his PSC, the services he provides to the business are treated as a 'secondary employment'. The authority would initially operate tax code BR which means income tax is deducted at basic rate. Employee NICs would be deducted at normal rates on £4,000 a month.

Employer NICs would be payable by the business on the deemed payment of £4,000.

The business will report and pay PAYE and NICs to HMRC. In due course, HMRC may issue the authority with a tax code to use against future payments made to Derek Ltd.

When the contract ends on 30 September 2020, the business should send to Derek a P45 showing the total deemed payment and deductions for PAYE and NICs.

If the contract extends beyond the 2020/21 tax year, the business should issue a P60 to Derek showing the total payment and deductions in the 2020/21 tax year.

The total amount invoiced by Derek Ltd and recorded as gross deemed payments by the business is £24,000 (6 X £4,000).

Assuming the tax code BR does not get adjusted the net deemed payments total (the figures below are based on rates and allowances for 2019/20):

	£
Amount invoiced	24,000.00
Less: PAYE - £24,000 at 20%	(4,800.00)
Less: Employee NIC – 6 x monthly NICs of £393.72	(2,362.32)
Total net deemed payments	16,837.68

If VAT has been charged by Derek Ltd, the business would pay Derek Ltd £16,837.68 plus the VAT charged on £24,000.

The business will also need to pay employer NICs. The monthly amounts due will be £452.78 which totals £2,716.68.

Effect in Derek Ltd

The company will get relief from corporation tax for the VAT exclusive amount of the invoices ie £24,000.

Procedure if Derek Ltd pays Derek the net deemed payment through the payroll

Any amount of income paid to Derek up to £16,837.68 will have already been subject to deduction of PAYE and NICs. HMRC guidance is that the payment should be recorded on a Full Payment Submission as non-taxable income.

Procedure if Derek Ltd pays Derek the net deemed payment as dividend

Alternatively Derek can receive a dividend up to £16,837.68. This will not be reported as a dividend on his self assessment return.

Effect for Derek

Derek would be treated as having received the net deemed payment from the company in the 2020/21 tax year irrespective of whether he has received it as salary or dividend (or even if he has not received it from his company).

On his 2020/21 self assessment return he will record the information supplied to him from the business:

Employment income	£24,000
PAYE deducted	£4,800

There may be a tax repayment due to Derek if he has not utilised his personal tax allowance against other income. Alternatively income received from the medium or large business may attract a higher rate tax liability, if Derek has other taxable income.