

As forewarned in the Autumn Budget 2017, on 18 May 2018 the UK government opened a [consultation](#) into off-payroll working in the private sector. More specifically, this concerns the use of personal service companies (PSCs) and the application of the IR35 rules in the private sector.

It is likely that the consultation will lead to the implementation of new rules the same as or similar to those that have applied to the public sector since April 2017, whereby the end-user (rather than the PSC) is required to determine whether IR35 applies and the responsibility for dealing with PAYE and National Insurance (NI) where IR35 does apply rests on the payer of the service company (i.e. the end-user or, if applicable, the agency rather than the PSC).

Background to the Consultation

IR35 applies a test based on whether the worker would have been an employee had they engaged directly with the end-user. If this is the case under the current private sector rules, broadly the PSC is required to operate PAYE and NI on the payments it receives for the relevant services. This is a good position for end-users and employment businesses, as they do not carry the risk of PAYE/NI non-compliance under IR35.

It is well known that HMRC believes there is widespread non-compliance with IR35 in the private sector, with it estimating that only around 10% of those within IR35 actually comply, whether due to lack of expertise or a belief that HMRC is unlikely to challenge the position. HMRC estimates that the cost of this non-compliance will reach £1.2 billion a year by 2022/23. HMRC is particularly aware of the difficulties it faces in enforcing compliance against a PSC. For example, HMRC must enforce against each PSC separately, whereas the quantum of tax at stake per PSC is often relatively low. The PSC may have no assets to pay the tax by the time HMRC is in the position to enforce. It can also be time-consuming and costly for HMRC to obtain the necessary information, particularly in the case of a complex supply chain. HMRC believes these difficulties are well understood and contribute to a perception of low risk in the case of non-compliance.

The changes to IR35 in the public sector were intended to deal with these issues in that sector and effectively operated as a trial for extending those changes to the private sector.

Various issues have been raised with the public sector reform, including that public sector end-users are applying the rules too cautiously (e.g. a blanket approach where all cases are treated as falling within IR35), the rules are encouraging more aggressive non-compliance, which defeats the object of a level playing field, and an increased administrative burden for end-users and agencies. HMRC has commissioned [research](#), which it believes shows that these concerns ("rumours") have been exaggerated and are not major issues in practice. It also discounts other concerns about possible mass walk-outs of contractors or higher costs in the public sector, although in any event, this type of concern could be used as a reason to bring the private sector rules into line with those in the public sector so that the public sector is not disadvantaged.

What Are the Likely Results of the Consultation?

There is likely to be some scepticism regarding the research commissioned by HMRC, but it is consistent with a very clear direction of travel toward the implementation of the public sector changes for the private sector. Based on previous indications and the wording of the consultation, it would now be very surprising if those changes were not made with effect from April 2019. Although HMRC welcomes suggestions of other options in the consultation document, it is very clear that extending the public sector reforms to the private sector is their preference. In fact, the other options that they do mention (e.g. requiring businesses to make more effort to confirm tax compliance within their labour supply chains or additional record keeping) could be additions rather than alternatives to the main option, and it is apparent that HMRC does not consider them to be a good solution on their own.

In practice, the consultation is, therefore, more likely to concern the exact details of implementation and how closely any reforms will mirror those in the public sector. HMRC's preference is likely to be for exact consistency between the rules in the public and private sectors for the sake of simplicity, but this is not a foregone conclusion.

What Are the Likely Implications of the Proposed Changes?

Despite HMRC's belief that the adverse effects of the IR35 reforms in the public sector have been exaggerated, many of the concerns regarding those effects will remain. There will be efforts to circumvent the new rules, ranging from the aggressive/unlawful to structuring arrangements to make it clearer that they fall on the right side of the IR35 test (e.g. via a "statement of works", which sets out the specific deliverables of the engagement to support the argument that the arrangement is not simply a supply of staff).

HMRC raises one particular area of non-compliance in the consultation document which it wishes to address, which is that some intermediaries in public sector engagements are ignoring the assessment of the end-user that IR35 applies.

The changes will obviously have a major effect on businesses in the staffing supply chain such as employment businesses, given the frequency with which a PSC model is used. However, many of those businesses will at least be familiar with most of the issues and potential implications given the public sector legislation that is already in place. This contrasts with the likely new obligations for private sector end-users, many of whom will only have had a passing interest in IR35 up to this point given that the tax risk currently falls on the PSC.

HMRC will be relying on most end-users being particularly cautious in their approach to the IR35 test and this is likely to be the case given the current climate around tax avoidance (including the recent introduction of a corporate criminal offence of facilitating tax evasion in the Criminal Finances Act 2017). However, this will then result in many contractors receiving less take-home pay leading to potential contract negotiations or contractors moving in favour of less cautious end-users.

Notwithstanding HMRC's confidence in its [online tool](#) for checking employment status, using the tool will continue to present difficulties in cases that are not already clear cut and the proposed reforms will put even more focus on the difficulty and uncertainty involved (as evidenced by a couple of recent IR35 tax tribunal decisions) in determining the distinction between employment and self-employment. End-users may, therefore, need to weigh up caution (e.g. applying a blanket approach to apply IR35 in all cases) against cost and the risk of non-competitiveness for labour.

There will also be a large amount of preparation for many end-users to consider their approach and ensure they have the correct processes in place to establish how each contractor should be taxed. Although we will not know for sure whether reform will follow until the government announces the results of the consultation, early preparation will be essential (e.g. considering whether existing and new contracts take account of the potential change in responsibility for accounting for PAYE and NI).

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