

Accountax Members Newsletter



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IR35 in the Public Sector — The Consultation

HMRC have released the next document in the consultation process on the reform of "off-payroll" working in the public sector. This is the consultation document itself. It should be read by anyone who provides services to that sector through a personal service company [PSC] or by anyone operating an agency or other intermediary who subcontract work within the sector to a PSC

Questions raised

It raises a list of 15 questions covering aspects of the operation of the proposed new rules. These cover:

- Definition of the public sector
- Obtaining Information
- How to deal with the 5% deduction in the deemed calculation
- How to decide if the new rules should be applied
- Transfer of liability rules
- Possible unexpected costs arising

The proposals

The proposed rules will apply to services provided through personal service companies (PSCs) either directly or via a second intermediary such as an employment agency or outsourcing company. As expected it includes an obligation for the engager of the PSC's services to deduct tax and NIC from payments made to the intermediary. This will be done by adding the individual who provides the service the engager's payroll. There are proposals for debt transfer rules but this was not entirely unexpected as it has been a common feature of previous legislation on intermediaries.

As always the document needs to be read carefully as there

are a number of underlying assumptions and definitions that indicate how the government is thinking. For example:

"..... evidence shows there is widespread non-compliance with the intermediaries legislation. The government estimates only one in ten PSCs who should be operating the rules on at least part of their income are doing so." [page 7]

and

"Most respondents to the discussion paper agreed non-compliance with the rules is widespread." [page 8]

These are probably intended as evidence for the need to reform the system but come without any solid statistical support. This is contrary to our experience of the operation of PSCs under current case law derived rules.

The public sector IR35 test

The consultation document states that the new rules will not make any changes to the basis of the test to be applied as it will use the existing factors. Specifically a supervision, direction or control (SDC) test will not be introduced. This is shown in the following quote:

"The basis on which the rules are applied to determine whether a worker would have been an employee if engaged directly is not changing." [page 11]

The current law asks

"if the services were provided under a contract directly between the client and the worker, the worker would be

regarded for income tax purposes as an employee of the client."[Section 50(c) ITEPA 2003]

That test would apply case law decisions on employment status. These consider the fundamental factors required to show employment exists. These are:

- the existence of an obligation to provide personal service,
- the existence of control over how the services are provided, and,
- Mutuality of obligations [MOO].

While there are also a number of secondary factors which may be considered although these normally only come into play if the decision cannot be made using the three fundamental factors. So we should expect the new rules to follow those precedents. However, the new rules as shown at diagram 4 on page 26 will only consider personal service and control!

The full test uses a two part mechanism, with the first part simply looking at the nature of the entity providing the test with some aspects of the service also being considered. This isn't too controversial and should be reasonably easy to apply. It is intended to prevent the rules being applied beyond the public sector and to businesses which are not regarded as PSCs. A flow chart is provided at pages 24 and 25 laying out the issues to be considered.

The proposed new rules will move the liability to make the determination, from the PSC to the public sector end-client, agency or other third party as applicable. This was expected from the initial announcements. It is also made clear that:

"Where there is more than one agency in the contractual chain, the legislation will apply to the agency that contracts directly with the PSC." [page 13]

There will be a requirement for the PSC to report details of the individual providing services to the public body or agency required to operate PAYE if the arrangements are caught by IR35.

As previously announced there is to be a new HMRC status tool for determining if IR35 applies. What is of concern is that the consultation questions do not include any that ask for opinions on the factors being used in that test so there is no question where respondents can raise the lack of MOO is being dropped as a determining factor. There is also nothing to make clear if the existing ability to use specialist third party opinions will continue or if they will be acceptable as evidence in any appeals.

Other points of interest

There are a couple of things in the document which while

not directly dealing with the new rules are worth passing mention. Under changes to IR35 made last year office holders providing services through a PSC are automatically caught by the existing rules. While there is no clear legal definition of an office holder or an office it is generally taken that an office is a position which exists independently from the existence of an individual currently holding the position. The consultation sneaks in a definition that isn't in line with this accepted usage stating that:

"An office holder is a person who has been appointed to a position by an organisation but doesn't have a contract or receive regular payment, such as registered company secretaries, crown appointments, club treasurers, trustees and members of the clergy."[Footnote – page 8]

Although the examples given are recognisably "offices" the first part of the definition is not in keeping with the accepted usage.

The other interesting quote states that:

".....it would be relatively simple to avoid the effect of this change by restructuring contracts to be about service provision rather than a supply of a worker." [page 13].

This appears to be a slanted reference to the interpretation of the last set of intermediary rules at s44 ITEPA where the phrasing appears to allow the rules to be ignored where the contract is for a service rather than the provision of labour.

Read and respond

The consultation document can be found at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/526614/Off-payroll_working_public_sector-reform_intermediaries_legislation.pdf.

The closing date for responses is 18 August 2016.



Supervision Direction and Control—HMRC's Guidance

HMRC's updated guidance on the application of the Supervision Direction and Control (SDC) rules were released on 6 April 2016. This is intended cover the application of SDC for the agency legislation (S44 ITEPA 2003) and the new employment intermediaries' travel and subsistence measures of s339A ITEPA 2003. It is noticeable that this new guidance does not follow the legislation, existing case law or even the original guidance published when the agency legislation was first released.

The guidance takes the form of new material to be included within the Employment Status Manual (ESM). It consists of guidance on the meaning of personally providing services and the nature and application of SDC.

Personally Providing Service

HMRC's revised guidance makes it clear that this does not require a named individual to be supplied. In HMRC's view the key issue is that an individual does some work. This is acceptable as a starting point but the guidance starts to depart from reality with the examples given. Example 3 for Nick the decorator under ESM2036a, demonstrates this. In that example an interior design company has a contract to design, fit and decorate a kitchen for a customer.

The example goes on to say that *"As part of that contract the design company agrees to supply the cabinets, worktops, appliances and to provide a fitter and decorator"*. Nick does the work and so in HMRC's simplistic view is personally providing services. Hence as Nick isn't contracting directly with the customer HMRC consider s44 to be applicable! HMRC have chosen an ambiguous description of what is being provided by the interior design company and then base the opinion on the very precise wording in the example.

This would catch each and every subcontractor providing services as part of a larger contract and wasn't the intention of the legislation. What this simplistic view doesn't take into account is whose service is Nick providing? As a subcontractor he is providing services to the interior design company to allow them to fulfill their obligation to the customer. The service being provided to the client is that of the Interior design company.

Where the guidance falls down is in not providing sufficient detail of the nature of the contract between the interior design company and its customer, which I suspect is deliberate. This simplistic view is repeated in further examples.

Supervision Direction or Control (SDC)

The first point of note in the guidance is that HMRC don't consider signed waivers and generic statements as satisfactory evidence of a lack of SDC or a right to SDC.

Secondly, although the guidance makes clear that SDC

applies in respect of the manner in which the individual provides the services, the examples go far beyond SDC in respect of how the service is provided. HMRC's excuse for this is that the meaning of SDC hasn't been tested before the courts. They then go on to divorce SDC tests from existing case law on control as applied in employment status and IR35 tests.

HMRC define supervision as *"the action or process of watching or overseeing what a person does or how something is to be done"*. They also consider that it includes a *"right to check the work that the worker is doing to make sure it meets a required standard"*. This is far too wide a definition and in our opinion should not include "the process of watching" as that is a passive activity while supervision suggests a more active role.

Direction is considered to entail *"making a worker do their work in a certain way by providing them with instructions, guidance, or advice as to how the work must be done"*. Again this is linked to "how" the work is done. HMRC's guidance goes on to state that *"Someone providing direction will often co-ordinate how the work is done as it's being undertaken"*. This goes beyond "how" into what where and when.

Last but not least HMRC define Control as *"telling or instructing a worker about how they do the work"* and includes, in HMRC's opinion, *"having the power to move the person from one job to another"*. This latter definition is clearly covering what, where and when to do the work but doesn't automatically include how to do the work. The guidance also states that agency workers who provide services in an industry where the work is *"governed by regulations or some other statutory framework or standards, will be subject to the right of SDC"*. This in HMRC's view will apply to health care workers such as doctors, nurses, social care workers such as social workers and social work assistants, teachers and teaching assistants.

With definitions like these it is hardly surprising that the examples provided go far beyond the intent of the legislation. The important point is that HMRC's opinion is not the law and as such this guidance is only an indication as to how they would like to have the law interpreted. We should be able to rely on any decisions that consider the application of SDC even if these are in respect of the old version of agency rules.

Until this guidance is tested before the courts it remains HMRC's opinion and no more. It has no binding force and is only of use in informing us as to the position HMRC are likely to take in any enquiry into travel and subsistence for umbrella workers.

First Ever Managed Service Company Appeal Heard

Its taken a while

It might seem strange, but, the first appeals under the Managed Service Company (MSC) legislation have only been heard by the First-Tier Tax Tribunal (FTT) in the last few weeks, despite the legislation coming into force back in 2007!

The Case

The case in question is *Christianuyi Limited and others v HMRC*. These are a group of appeals from medical practitioners, heard together before the FTT against determinations to Income Tax and NIC notices of decisions totalling some £160,000.

The appeals dealt with the contractors use of Personal Service Companies to provide their services to third parties and whether these were caught by the Managed Service Company (MSC) rules through the involvement of Costelloe Business Services Ltd (CBS) as an MSC provider. If that was the case then the determinations had been properly issued and the liability they created was properly due from the individual's companies.

The MSC rules

The MSC legislation applies income tax and NIC to all of the fees paid to a contractor via the MSC. For there to be an MSC it must be shown that:

1. A company provides the services of an individual to a third party
2. The individual receives payments that are directly linked to the fee for the service provided
3. The individual receives more pay than they would had they been employed by the company
4. There is an MSC provider and,
5. The MSC provider is involved with the company

The Decision

It was accepted that CBS were an MSC provider but it was denied that they were "involved" with the service companies. The FTT rejected the appeal and confirmed the validity of the determinations raised and gave a detailed analysis of why they considered that CBS was involved in the service companies for the purposes of the MSC legislation. That analysis makes disturbing reading as it highlights the lack of understanding by the contractors as to the risks they were undertaking and the nature of an MSC.

Specifically the FTT considered that CBS was "involved" as the company:

- had some measure of control over the PSC bank accounts which influenced payments to the contractors and the PSC's finances,
- benefitted financially from the provision of the contractors services,

Further hearings to come

It appears that there is a second case pending which if successful will allow HMRC to apply the debt transfer rules and pass some or all of the debt to CBS. This is clearly the thin end of the wedge as the judges in the case said that they:

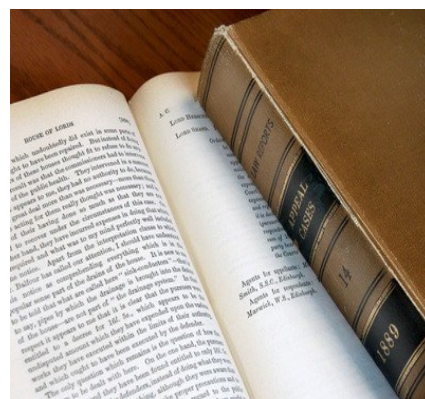
".....understand that there are a number of other appeals concerning this legislation which are pending before the First-tier Tribunal."

Lessons need to be learned

Contractors who are involved in the use of PSC's where the company is set up by their agency or in part is run by anyone other than the contractor themselves should ask one important question: "How can I be sure that this isn't an MSC arrangement?" We are hearing stories from concerned contractors who have entered into arrangements with intermediaries which HMRC are now attacking as they believe them to be caught by the MSC rules. In many cases the contractors were not warned about the nature of the arrangements or the potential risks when they signed up with the intermediary. For many contractors this decision comes too late to allow them to ask about the risks in their arrangements as the damage has already been done.

Going forwards, with the increase in the use of PSC arrangements by labour provision businesses this is an area which should be carefully considered by both agencies and contractors. The message is clear if in doubt seek an expert opinion.

For more assistance with these matters please contact David Harmer or David Geldard on 0345 0660 035.



Employer Compliance Issues—Directors Loan Accounts

Director's Loan Accounts (DLA) have become a routine target for HMRC investigators during employer compliance reviews. After HMRC have confirmed that DLA's are used the next question is always *"Can I see a chronologically dated schedule of payments into and out of that account, along with a full explanation of each transaction"*. This is usually when the problems come out.

The benefit in kind charge on an overdrawn loan account applies where the account has been overdrawn by more than £10,000 at any point in the tax year. The benefit in kind charge is calculated where interest hasn't been charged against the overdrawn amounts. The amount subject to charge is the difference between the interest charged and the interest which is due using the HMRC published interest rates. There are two methods available for calculating the charge the average method or the exact method. Under the averaging method the opening and closing balances are used to calculate the balance over the year. Where both balances are positive then no chargeable amount arises. However, it is open to both HMRC and the taxpayer to elect to use the "Alternative precise method". This looks at the balance throughout the year and calculates interest on the actual balances on a daily basis.

Common mistakes in operating a DLA

The commonest mistake we see is a loan account which isn't monitored during the course of the year. Often the loan account is only drawn up at the year end with a dividend being

declared to clear any overdraft. Although there may be a suspicion that the account has become overdrawn the size of that overdraft isn't known until after the event.

This is why HMRC have started asking for the details in chronological order. It allows them to calculate a running balance and see if the account has been overdrawn by more than £10,000 at any point. This liability is separate to the requirement to charge Corporation Tax against any overdrawn amount not repaid within 9 months of the end of the accounting period. The two sets of rules operate in parallel to each other and a charge can arise under both.



2016 Accountax Autumn Seminars

Although still only at the planning stages we can confirm that we will be running our annual series of seminars across September 2016. We will be following up on the popularity of the additional seminars held in 2015 on Umbrella, agency and contractor rules by again holding additional specialist seminars on these issues.

Further information on topics to be covered, speakers, dates and venues will be sent out in the next few days. Additional locations may be added if there is sufficient demand so if the location of your choice isn't on the list please let us know.

The locations are:

Leeds	Tax
Manchester	Tax and Umbrella
Southampton	Tax
Bristol	Tax
Birmingham	Tax
London	Tax and Umbrella
Milton Keynes	Tax and Umbrella