Off-payroll working in the public sector: reforming the intermediaries legislation

Technical note 16 March 2016

Introduction

The Government announced at Budget 2016 that it will reform the intermediaries legislation[1] for public sector engagements. Liability to pay the correct employment taxes will move from the worker's own company to the public sector body or agency / third party paying the company.

Legislation will be introduced in Finance Bill 2017 and will be subject to full consultation. In partnership with stakeholders, HMRC will develop a new digital tool that will make the decision on whether or not the rules should apply as simple as possible and provide certainty.

HMRC recognises that there is strong interest in these proposed changes. This note provides further details on the changes that are being proposed. Chapter 1 gives an overview of the changes. Chapter 2 provides further technical details about the proposed changes. Chapter 3 sets out next steps, including the scope of a consultation document that will be published shortly.

[1] Chapter 8 Part 2 Income Tax (Earnings and Pensions) Act 2003

Chapter 1 Overview of the change

1. The intermediaries legislation was introduced in 2000 and requires individuals working through an intermediary to pay broadly the same tax and National Insurance contributions (NICs) as employees, where they would have been an employee if they had provided their services directly. An intermediary in this context is typically someone's own limited company, often known as a personal service company (PSC).

2. Many people find the rules confusing and there is widespread non-compliance. At the Summer Budget last year, the government published a discussion document and engaged with stakeholders on how to improve the effectiveness of the legislation.

3. Public sector bodies have a responsibility to taxpayers to ensure that the people working for them are paying the right tax. From April 2017, individuals working through their own company in the public sector will no longer be responsible for deciding whether the intermediaries legislation applies and then paying the relevant tax and NICs. This responsibility will instead move to the public sector employer, agency, or third party that pays the worker's intermediary. The employer, agency or third party will have to decide if the rules apply to a contract and if so, account for and pay the liabilities through the Real Time Information (RTI) system and deduct the relevant tax and NICs.

4. Many public sector bodies are already required to seek assurance that some of their workers are paying the correct employment taxes under Government rules on off-payroll appointments in the public sector. This change will reinforce and extend this requirement across all public sector bodies and all workers engaged through a PSC.

5. Where a public sector body engages a PSC through an agency, or other third party, the party closest to the worker's limited company in the supply chain will be required to comply with the rules.

6. HMRC will provide help for public sector employers and agencies with their new responsibilities. In partnership with stakeholders, HMRC will introduce clear, objective tests for employers to use to decide at the point of hire whether or not they need to even consider the new rules and then to quickly and decisively identify those engagements that are clearly caught by the rules.

7. For cases that are less clear cut, HMRC will develop a simple and straightforward digital tool to provide employers engaging an incorporated worker with a real-time HMRC view on whether or not the intermediaries rules need to be applied. HMRC will be designing these new tools and tests in consultation with stakeholders.

8. The existing intermediaries rules will continue as they are now for non-public sector engagements. Businesses and agencies working outside of the public sector will also be able to make use of the new digital tool.

Chapter 2 Technical details

Overview of the new rules for off-payroll workers in the public sector

9. The new rules will make public sector engagers, or the third parties who engage workers through PSCs on their behalf, responsible for determining whether the intermediaries legislation applies and then collecting the relevant tax and NICs. Where these new rules apply, they replace the current rules that apply to personal service companies and other intermediaries.

10. Set out below is further detail on the proposed scope of the new rules and the mechanism for paying the correct income tax and NICs due. Further details on both aspects will be provided in the course of consultation in the period ahead.

The scope of the new rules

11. The new rules will apply to payments to intermediaries providing the services of a worker to a client in the public sector. Public sector will mean organisations that are Public Authorities for the purposes of the Freedom of Information (FOI) Act 2000 and Freedom of Information Act (Scotland) 2002.

12. The FOI Acts define the public sector under broad categories (this is not an exhaustive list):

    - Government departments, legislative bodies, armed forces
    - Local government
    - NHS
    - Schools and further and higher education institutions
    - Police
    - Other public bodies (listed in a Schedule including bodies such as The British Museum, BBC, Channel 4)
    - Publically owned companies (wholly owned by the Crown and/or the wider public sector such as Transport for London)

13. Chapter 8 Part 2 Income Tax (Earnings and Pensions) Act 2003 which contains the intermediaries legislation explains what is meant by an intermediary in this context. It is most commonly an individual's own company or a partnership they work through.

14. Where the public sector organisation engages directly with the intermediary, the public sector organisation will be responsible for operating the new rules and then collecting and paying the relevant tax and NICs.

15. Where the public sector organisation engages the worker indirectly through the third person (the agency) that third person is responsible for operating the new rules and collecting and paying the relevant tax and NICs. The public sector body will

need to inform the agency that they are contracting with a public sector body within these rules. The public sector body will also be required to check that the agency operates the rules correctly.

16. The reformed rules will not apply for workers provided through an agency or similar business where the workers are employees of the agency and not supplied through their own company.

17. There will be special rules where there are more complex contractual chains, for example involving a series of agencies, or when the liable agency or organisation is offshore. Where a public sector body engages a worker through a chain of agencies, or other third parties in a chain, the party closest to the worker's limited company in the supply chain will be required to comply with the rules.

18. To help engagers make the decision as to whether the contract would have been for employment or self-employment, HMRC will provide simplified guidance, including a digital tool to provide up front certainty. Answering the questions in the guidance and using the tools will give the engager HMRC's view of the correct tax treatment.

Paying the Tax and NICs

19. To work out the correct amount on which to pay tax and NICs, the engager will need to calculate an amount of deemed employment income (and earnings for NICs). That amount is the amount of the payment made to the intermediary, less any VAT charged. It will also include a 5% deduction, reflecting the existing 5% deduction rules that apply to PSCs. Whilst this is the current assumption for how the rules will work, HMRC will consult on the detailed rules to ensure they remain as simple as possible to operate. The balance is then to be included for RTI purposes and returned to HMRC in the normal way. The engager should operate all expenses and other allowable deductions and allowances as if this were a normal direct employment. Responsibility for paying employer NICs on the deemed employment income will also shift from the PSC to the relevant engager.

20. The new measure will require the public sector organisation or the agency engaging the worker on their behalf, to obtain the necessary personal, company and tax information needed to operate RTI from the worker's PSC.

Example 1 – Central Government – rules apply

Grace works through her own PSC and is appointed as a senior analyst at the Ministry when the post holder leaves. She is a locum appointed to a project for 5 months while the job is advertised. Human Resources uses HMRC's online tool to see that Grace is working in the same way as an employee and the new off-payroll tax rules apply. Payroll are informed and tax and NICs are deducted from payments made to Grace's PSC. The Ministry pays the secondary NICs and accounts for the tax and NICs liabilities under RTI.

Grace's PSC invoices the Ministry monthly for £2400, which includes £400 VAT. The Ministry treats £2000 as Grace's earnings and deducts £223 tax and £159 employee NICs, which it pays to HMRC via RTI with £183 employer NICs. The Ministry pays Grace's company £1618.*

Because Grace has paid income tax on income going into the PSC, she receives a credit against employment and dividend income drawn out of her PSC so she does not pay tax twice. The corporation tax liabilities of Grace's PSC will remain unchanged by the measure.

Example 2 – Local Government using an agency – rules apply to the agency

Charlie is a locum social worker within the Child Protection team at a County Council. The Council contracts with an agency to supply Charlie for 9 months. He is not an office holder under the Local Safeguarding Children Board Regulations (otherwise he would be automatically required to be on the payroll under the current legislation). The agency contracts with Charlie's PSC. The agency checks HMRC's new tool to see what the tax position is and finds that the off-payroll rules apply.

The agency must deduct tax and NICs on the payments it makes to Charlie's company. Charlie's PSC charges the agency £1500 per month for his services. Charlie's company is not registered for VAT. The agency treats £1500 as Charlie's earnings and deducts £123 tax and £99 employee NICs. It accounts for this via RTI and pays the tax and employee NICs to HMRC along with £114 employer NICs. Charlie's PSC receives £1278.*

Charlie receives a credit against employment and dividend income drawn out of his PSC so he does not pay tax twice. The corporation tax liabilities of his PSC will remain unchanged by the measure.

Example 3 – Contractor – rules do not apply

Tanya is a graphic artist with an established business and a number of clients. She works through her own company. Tanya's company tenders for work and is hired through her company by the County Council to decorate schools with attractive murals.

When it engages Tanya, the Council's contracting department uses HMRC's online tool to check if the new rules apply to Tanya. The tool asks some questions about the engagement and advises the engagement would not have been one of employment if the contract had been directly between the Council and Tanya. No further action is required.

There is no change in the taxation of Tanya or her company.

* for simplicity, examples do not include 5% expenses which we will be consulting on.

Chapter 3 Next steps

Consultation

21. As set out above, the proposals outlined in this note will be published in more detail in a consultation document before the summer. This will invite views from stakeholders, including on the following points:

- the definition of the public sector for the purposes of these changes and impacts on specific groups;
- the development of the new test and tools for determining whether an engagement should be considered employment for the purposes of employment taxes; and,
- how the 5% expenses deduction would work with the new rules.

Legislation

22. The government will bring forward legislation to effect these changes in Finance Bill 2017 and in matching National Insurance contributions legislation. Draft clauses will be published later in the year, alongside the Finance Bill.