07.02.2020

IR35 debt transfer rules increase the stakes all round

As per our earlier bulletin on 24 January, HMRC have finally revealed a key piece of the proposed IR35 legislative reform set for this coming April.

We have been tracking developments closely as this aspect of the new rules fundamentally impacts where IR35 risks sit in the supply chain, and where it can ultimately end up. Unfortunately the draft new regulations raise several potential issues for agencies and end user clients, and only adds further to the already muddy waters of IR35 liability.

How will the new debt transfer rules work?

After 6 April 2020, HMRC will have a new power to issue an IR35 recovery notice to various parties in the supply chain, where IR35 duties have gone unpaid.

This recovery notice only applies to IR35 debts that relate to the period after 6 April 2020, so cannot be used to recover tax and NIC from earlier periods (which remain the responsibility of the PSC or, if appropriate, the public authority end client/fee payer from April 2017).

Who can be sent a recovery notice?

Frustratingly, the new rules say that HMRC can only issue a tax recovery notice to a "relevant person" and refer to a new definition in the draft Finance Bill. The Finance Bill as originally published does not actually include this definition, so we don't know what it is. We assume it is intended to add the definition when the Finance Bill goes through Parliament.

However, the draft National Insurance legislation does include a definition, and as they are supposed to mirror each other we believe that they will be the same.

The draft new NIC rules say that HMRC can issue a recovery notice to either the second highest person in the supply chain (typically an agency) or to the person at the top of the supply chain, i.e. the end client.

The original Finance Bill suggested that the PSC and the worker may also be subject to the debt transfer rules, but this no longer appears to be the case.

There is no provision to impose personal liability on directors of companies in the supply chain.

Under what circumstances can HMRC issue a recovery notice?

There are some important conditions here.

Firstly, a valid Status Determination Statement ("SDS") must have been issued by the end client. If the end client is already liable by default, HMRC cannot issue a debt transfer notice.

This gives rise to the potential for argument that there is no valid SDS in place, or that the liability has already come back to the end client in one of the many ways this can happen (see our newsletter on the complex SDS provision). It might even be in the end client's own interests to argue this itself – see the idiosyncrasy below concerning appeal rights.

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Secondly, HMRC must decide that there is no reasonable prospect of recovering the IR35 liability from the person originally liable for it within a reasonable period of time. .

Thirdly, there is an order of recovery. HMRC must start with the second highest person in the supply chain and, only if HMRC decide that there is no reasonable prospect of recovering the IR35 liability within a reasonable period of time from that person, can they then go on to seek recovery from the end client.

Fourthly, there are important time limits. HMRC must have raised an IR35 assessment and it must have become final and conclusive and have gone unpaid for 30 days. HMRC must then issue a recovery notice within 2 years. If HMRC cannot make an assessment due to the liquidation or dissolution of the original liable party then, subject to the normal assessing time limits HMRC can proceed directly to third party debt recovery. In this case the actions and reasonable care taken by the original liable party would become relevant as this can extend to assessing time limits from 4 to 6 years.

Fifthly, HMRC have said that they will not use the debt transfer provision in cases of 'genuine business failure'. There is no definition or guidance as to what this means and, quite incredibly for such an important protection, this restriction is not included in the draft legislation. We will simply have to trust HMRC on this one (irony fully intended).

Challenging a recovery notice

A person receiving a recovery notice can appeal against it on any of the above grounds – e.g. that the notice is out of time, or that HMRC could recover the tax and NICs due from a person further down the supply chain within a reasonable period of time.

The most important ground of appeal of course is likely to be that IR35 does not actually apply. In our view, there is a problem with the draft rules here. The legislation states that an appeal against a recovery notice can indeed be made on this basis, but not if the IR35 position has already been determined in an earlier appeal.

This makes sense if the matter has already gone to Tribunal and been resolved. However, the expression 'determined on appeal' has a much wider meaning. If an appeal is settled by agreement, or withdrawn by the appellant, it is deemed to have been 'determined' (under section 54 Taxes Management Act 1970). Likewise, if HMRC offer an appellant an independent review of an appeal and the appellant does not reply to accept it within 30 days, the appeal is automatically 'determined' in favour of HMRC.

Therefore, the scenario could arise whereby the original liable party withdraws from an appeal, or simply does not respond to HMRC's offer of an independent review. Clearly this is much more likely in a case of insolvency or cessation of trade. The problem for an agency or end client is that they would then be subject to the IR35 debt transfer without any opportunity of arguing that IR35 does not apply. This seems hideously unfair.

In such circumstances, whilst it seems bizarre, it would probably be beneficial for a party to argue that it was already liable by default. This would open the door for the party to be assessed directly, and to challenge the IR35 assessments on appeal.

Summary

As with most things IR35-related, the legislation is complex and quirky. These debt transfer rules make something of a mockery of the whole procedure of issuing an SDS to pass the liability along the supply chain, and are likely to encourage a whole host of peripheral arguments about liability in an IR35 dispute.

The solution to the IR35 problem is, as ever, to ensure that there is no disguised employment: which, with a willingness to contract on a genuine freelance basis, is usually a straightforward matter in most cases. Coupled

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with clear and properly drafted written contracts, a robust defence and good representation, it is not difficult to remain IR35 compliant and to avoid the messy legislation described above.

Consultation

The draft legislation is open for consultation until 19 February 2020.

As an aside, in addition to the consultation on the debt transfer rules, there are currently two other reviews of IR35 underway: as well as a review of the introduction of the reform announced on 7 January, the House of Lords Economic Affairs Committee has issued a call for written evidence for the purposes of its own enquiry into the reforms.

Despite this Parliamentary activity, we expect the reforms to go ahead in April 2020 as originally announced.

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