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HMRC Guidance on IR35

On 27 February 2020, HMRC published draft guidance on the off-payroll working legislation: Chapter 10, ITEPA 2003, which is due to come into force from 6 April 2020. Our newsletter this week concentrates on certain parts of the draft guidance, focussing on areas in which we have received a number of questions.

Prior to looking at various aspects of the draft guidance, it is important to highlight that the guidance published is only a draft version – whilst parts of it are helpful, it should be approached with caution as it is only guidance (and not the law) and, HMRC can change their guidance at any time and frequently do.

Application of the legislation

The guidance sets out HMRC's position in respect of Chapter 10 of ITEPA 2003 (the new IR35 rules) and therefore is useful for organisations that are either a public authority or are a medium or large sized business in the private sector.

A number of businesses and PSCs have asked us the question on how the payments should be treated if the work was carried out prior to 6 April 2020. However, payment is due to be made by an organisation (who would need to apply the new IR35 rules) after 6 April 2020.

HMRC have set out guidance in relation to this very point. Prior to focussing on the guidance, it is always useful to remind our readers that the definition of a public authority has been extended in the new IR35 rules to include 'a body specified in s23(3) of the Freedom of Information Act 2000' and 'a company connected with any person' that is defined as a public authority in the legislation. This distinction is important as the manner in which payments should be treated, will vary accordingly (see below).

Where an organisation falls within the current definition of a public authority (and is, therefore, subject to the current public sector IR35 rules), HMRC have stated that "*the new rules will apply to payments made on or after 6 April 2020 regardless of when work was carried out.*"

However, where an organisation has been newly added to the definition of a public authority or is a medium or large sized organisation in the private sector, then HMRC have stated that the "*new rules will apply to payments made on or after 6 April 2020 only where the services were also provided on or after 6 April 2020.*"

For such organisations, it therefore confirms that if services were provided before 6 April 2020, then the old rules (i.e. the current IR35 rules) will continue to apply, regardless of when payment for those services is made to the PSC. We understand from the conclusion of the recent Government review into the proposals that this provision is due to be incorporated into statute (which we hope will be published following the Budget next week).

Overseas client

Another question which we have seen come up a number of times is whether the rules apply when the client is based overseas.

HMRC's draft guidance on this matter makes it clear that where a client is a wholly overseas client then they are excluded from the new IR35 rules. A wholly overseas client exists where:

"A client is based wholly outside the UK if it does not have a UK connection in the form of being UK resident or having a permanent establishment"

In such instances, Chapter 8 of ITEPA 2003 (i.e. the current private sector IR35 rules) will apply and the worker's PSC will need to apply the rules.

If, however, the client does not fall within the definition of being a *wholly overseas client*, then the new IR35 rules may need to be considered for tax and NICs, however, this will depend on the worker's domicile and residency status. Where organisations are unsure on whether the rules need to be considered then it is advisable to obtain professional advice.

Identifying the client

In most cases it is a relatively straightforward matter to determine who the client is and be aware of the applicability of the rules and the responsibilities of each party in the contractual chain.

However, there are instances where it is difficult to identify who the client is. This is partly due to services being contracted out and the complex nature of some supply chains.

HMRC have provided draft guidance on this very point and have confirmed that *"Where a person enters into a contract for a fully contracted out service, they will not be the client. This is because the worker's true client is the party who the work has been contracted out to; the 'service provider'."* Essentially, where a person contracts out the services, they will not need to consider the new IR35 rules.

Determining whether the services have been **fully** contracted out or not can get complicated and HMRC have stated that *"Whether a contract is for a fully contracted out service is a question of fact, based upon the commercial reality of the arrangements."* Whilst HMRC have tried to list certain factors which should be considered, those factors alone are not helpful. The guidance does however provide some examples of what does and does not constitute fully contracted out services.

HMRC's compliance approach

The draft guidance refers to HMRC educating, supporting and raising awareness in relation to the use of avoidance schemes. However, the approach in relation to ensuring compliance, which HMRC will adopt is set out as the following:

"HMRC will ensure that customers trying to comply with the off-payroll working rules are not disadvantaged by those who are not. HMRC will focus on and address the most significant risks around non-compliance."

What the guidance fails to explain is how HMRC will assess where the most significant risk is. If past experience is anything to go on, then HMRC may well open enquiries into several organisations to determine if the new IR35 rules are being complied with – which would be in line with the approach that HMRC adopted when the public sector IR35 rules came into effect.

One aspect of HMRC's compliance approach which has been much talked about is their *"light-touch approach"*; it should be remembered (as is confirmed in the draft guidance) that the light touch approach **only relates to the issuing of penalties** in the first 12 months and does not relate to any potential underpayment of tax and NICs.

Comment

The draft guidance published last week is useful in providing HMRC's current position in relation to the new legislation. As stated though, it is only guidance, subject to change and is not the legislation – which must always be the starting point for compliance.

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