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Updated IR35 legislation released for public sector workers

As promised in our bulletin on 20 March, below is an analysis of the changes to the IR35 legislation for PSCs engaged to work for a public authority client. The 2017 Finance Bill has now been published and, whilst subject to the usual parliamentary procedure and approval, contains the latest draft of the legislation containing a few changes and new provisions. Some of these changes will have a significant impact on the way PSCs operate in the public sector from 6 April 2017. If anecdotal reports are to be believed, it may not be long before these rules are also widened to include the private sector.

For a reminder of the background to the changes and details of the initial draft of the legislation, please see our previous coverage.

Some of the changes are of a technical nature, such as expanding the definition of a public authority to include Corporate Officers of the Houses of Commons and Lords, and excluding statutory auditors from the new rules – clearly of no more than a passing relevance for most.

There are also some technical changes to the way IR35 'caught' payments are processed – the most notable being that the fee-payer (i.e. the person paying the PSC, and responsible for operating PAYE if the arrangements are caught by IR35) now has the option to tax the whole payment or exclude allowable employment expenses from the calculation. Previously it was mandatory to exclude allowable expenses.

Other amendments have clearly been designed to plug a few holes in the legislation. For example, the first draft of the rules provided an exemption from public-sector IR35 if the Managed Service Companies ("MSC") legislation applied. This has been removed. Presumably HMRC did not want to face a situation whereby an agency or other fee-payer could argue away liability on the basis that the PSC was a Managed Service Company, which would have resulted in the parties becoming embroiled in a lengthy satellite dispute about a different piece of legislation altogether. It does appear however that the situation is different the other way around – i.e. public sector IR35 supersedes the MSC legislation. In other words, a person caught by the MSC rules could put forward a defence that they were working for a public authority client as a disguised employee. This would then shift liability away from the PSC (which is where it sits under the MSC rules) to the person paying the PSC (which is where it sits under the public sector IR35 rules). Interestingly, the recent *Christianuyi* case (so far the only case on the MSC legislation) involved workers in the health and social care sectors, where public authority clients are commonplace.

The other potential 'loophole' plugged by the changes ensures that anybody who had the bright idea of inserting another intermediary into the supply chain just to pay their PSC so that they could avoid deductions being made will be foiled. Offshore entities and companies associated with the PSC are ignored when it comes to deciding who the fee-payer will be for the purposes of the new rules. Association is drafted widely.

These minor tinkerings aside, there are also some fundamental alterations to the information that has to be passed between the various parties involved in the arrangements, and the consequences for failure to follow the rules.

Those that have been following the development of this legislation will recall that under the original draft rules the end-client had a duty to provide a view on the applicability of IR35, and had to answer questions raised

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about the decision it had reached. However, there was no sanction for failing to answer questions, and as long as the end-client provided a view within 31 days of a formal request by the agency, no liability or responsibility rested with the end-client, even for providing an incorrect view of IR35.

This has now radically changed. Under the revised legislation from 6 April 2017 the end-client must provide a view on the applicability of IR35 before the contract is agreed, or, if later, before the services under the contract start. Failure to do so shifts liability and responsibility including any employer's National Insurance on to the end-client.

Moreover, an agency can now put written questions to the end-client about its reasons for reaching its decision, and the end-client must respond to those questions within 31 days of receipt. Again, failure to comply with this deadline shifts the liability from the agency (or other fee-payer) directly on to the end-user.

In addition to these significantly more onerous responsibilities there is now a positive duty on the end-client to take 'reasonable care' in reaching its conclusion about whether or not IR35 applies. Failure to take reasonable care yet again results in a liability shift to the end-user.

These changes (in particular the reasonable care requirement) have already been hailed as positive news for agencies, however whilst superficially helpful a moment's thought about the implications brings to light an obvious issue here. End-clients are now compelled to make an early IR35 decision. Whilst there could be liability passed to the end-client for incorrectly and unreasonably concluding that IR35 does not apply, **there can be no liability for incorrectly concluding that IR35 applies** – as there is no IR35 liability to transfer in a case where IR35 does not apply.

This will inevitably lead to the long-feared 'safe approach' of end-clients simply concluding that all PSC contractors are caught so as to avoid any potential liabilities under the new debt transfer rules. This is going to be unhelpful to agencies trying to recruit PSCs in the public sector.

Another problem is that having to make an early decision before the contract is even signed gives little opportunity to consider many of the factors that can be relevant to the IR35 determination – factors which determine whether the contractor is operating in business on their own account and which case law has established (and even HMRC concede) are an important part of the status test.

Finally, being slightly mischievous, the legislation does not place any limit on the number of questions that an agency can pose to the end-client, nor the extent of them – nor indeed how many times such a written request can be made. Failure by the end-client to respond in writing to such questions within 31 days' results in the end-client bearing the PAYE responsibility. A savvy agency might bombard an end-client with employment status questions (much like HMRC do!) in the hope that a response isn't forthcoming and the PAYE responsibility is shifted. Conversely however (and equally mischievously) the legislation doesn't actually say the end-client must answer the questions – merely to respond. A two-word response would technically suffice!

In addition to this change, there is also now a positive obligation on the worker (not the PSC) to inform the person paying the PSC whether the IR35 conditions of liability apply. For a limited company this means whether or not the worker has a 'material interest' in the company. If the worker does not explicitly inform the agency that the conditions of liability are not met, the agency has to assume that they are.

This has potentially huge implications for any agency paying any intermediary – whether it is a PSC, an umbrella company or any other form of intermediary. It is often assumed that IR35 is targeted at one-person service companies, but technically the rules can apply to any intermediary, including an umbrella company. The reason IR35 does not apply to umbrella company workers is typically because the worker does not have a material interest in the umbrella company and/or because the worker is drawing all remuneration as salary under PAYE.

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However, the latter is irrelevant under the new rules, and the 'material interest' test is deemed to be met **unless the worker explicitly confirms otherwise** to the fee-payer.

It remains to be seen whether this is just careless drafting, or whether HMRC may actually use this aspect of the legislation to seek PAYE from an agency under the IR35 deemed salary rules in a case whereby, say, an umbrella company supplying a public sector worker fails to meet its PAYE responsibilities.

Finally, the 'fraudulent document' debt transfer provision remains as per the original draft, with the added specific provision that a fraudulent written statement from the worker that the IR35 conditions of liability mentioned above are not met results in a transfer of IR35 responsibility directly to the PSC. Bizarrely, given the absence of any appeal provision, in a case whereby an end-client makes an incorrect blanket decision that IR35 applies providing a deliberately incorrect document and taking the IR35 responsibility back onto its own shoulders might be a PSCs best option to avoid the unwarranted deduction of PAYE.

If you have any queries about the application of the new rules, contact the Chartergates team.

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