

New Tax Risks for Organisations Engaging Contractors in the UK from 2020

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Employment and Tax

From April 2020, new rules will require all large and medium-sized private sector organisations to determine the employment status of their contractors and, where applicable, withhold tax and social security and pay employer social security on payments made to relevant contractors.

Public sector organisations hiring such contractors have been subject to this obligation under what is widely known as the IR35 regime for some time. From next year, the UK Government has ensured the private sector will also be caught.

The UK's IR35 legislation was originally introduced to ensure independent contractors paid the same tax and National Insurance contributions ("**NICs**") as an equivalent employee. IR35 is aimed at contractors who (a) operate through an intermediary organisation, typically a personal service company ("**PSC**") (a limited company they own), and (b) would otherwise be classed as employees in the absence of the intermediary. Such individuals are considered by HM Revenue & Customs ("**HMRC**") to be "disguised employees".

Why is this happening?

Since 2000, contractors have been responsible for self-assessing their IR35 status and NICs. This arrangement has been ineffective and HMRC estimates that, under the current rules, the cost of non-compliance in the private sector would escalate to £1.3 billion by 2023/24.

What is changing and who does this affect?

All relevant private sector businesses (see below) will become responsible for assessing the employment status of the "off-payroll workers" they engage (including consultants) from April 2020, effectively shifting the current burden on PSCs to the client in receipt of the services (the "**end-user**"). Where the end-user concludes that IR35 applies (i.e. that the contractor is a 'disguised employee'), they will be responsible for accounting for and paying the related tax and NICs to HMRC, including the additional cost of employer NICs. This will create an additional cost of at least 13.8% (of the individual's "fee") for the end-user. In other words, if the PSC is treated as a disguised employee, then the end-user must operate PAYE in the same way that it would for any other employee, i.e., deduct tax and national insurance at source.

The new rules will apply to: (i) large and medium businesses in the private sector that are the end user of the services; (ii) the fee-payer (if different); and (iii) contractors providing services to

large and medium businesses. Where the end-user is a small organisation, the PSC will (for now at least) continue to be responsible for assessing whether IR35 applies. The Companies Act 2006 defines a small company as a company with two or more of the following features: (a) turnover of £10.2m or less; (b) a balance sheet total of £5.1m or less; and (c) 50 employees or fewer. Those businesses in the private sector which do not tick two of these boxes will be considered “medium” or “large” for these purposes. A small company that is part of a group that is “medium” or “large” using the above test will be subject to the new legislation. Limited liability partnerships are required to adapt the above tests “subject to any necessary modifications”.

Why is this important and what next?

The shifting of the burden for assessing whether IR35 applies is an unhelpful development for many organisations that rely on independent contractors. The additional checks that organisations will inevitably have to undertake are likely to be burdensome (in terms of time and cost). Organisations should already be considering whether additional processes could be implemented to assist with IR35 assessment and compliance, as well as associated PAYE withholding obligations.

Organizations that fail to comply with the new rules are at risk of financial penalties or unpaid tax and NICs. In addition, the Criminal Finances Act 2017 introduced two new criminal offences: (i) failure to prevent facilitation of UK tax evasion; and (ii) failure to prevent facilitation of foreign tax evasion. A company commits an offence if it fails to prevent the facilitation of tax evasion by an 'associated person' - which could include a contractor seeking some unlawful tax benefit from disguising an employment arrangement as a consultancy.

End-users therefore potentially face additional risks if an IR35 assessment is not undertaken for each contractor from April 2020.

The UK Government launched a further consultation on the future of IR35 earlier this year, and has now published draft rules and guidance, which can be found [here](#).

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Employment and Tax practices:

Chris Bracebridge	+44 20 7067 2063	cbracebridge@cov.com
Guy Dingley	+44 20 7067 2026	gdingley@cov.com
Antonio Michaelides	+44 20 7067 2027	amichaelides@cov.com

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