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## New Tax Rules for Personal Service Companies, Recruitment Agencies and Medium or Large Businesses

From 6 April 2020, new tax rules are proposed for individuals who provide their personal services via their Personal Service Company (PSC) to a Medium or Large Business.

The effect of these rules, if they apply to you, will mean:

* The entity that pays the PSC for the services must first deduct PAYE and employee National Insurance Contributions (NICs) as if the deemed payment is a salary paid to an employee.
* The paying entity will have to pay to HMRC not only the PAYE and NICs deducted from the deemed payment, but also employer NICs on the deemed payment.
* The net amount received by the PSC can be passed onto the individual without paying any further PAYE and NICs.

The practical effect of these rules is that you will no longer benefit from the potential tax advantages of receiving such income via your own company.

There may also be pressure from businesses to renegotiate contracts due to their increased cost of employer NICs.

The new tax rules apply to amounts paid from 6 April 2020 and so may affect current contracts.

## What is a medium or large business?

The government intends to exempt small businesses from the new rules. A small company meets any two of these criteria:

* Turnover of £10.2 million or less;
* £5.1 million on the balance sheet or less;
* 50 or fewer employees.

## Who will decide if the rules apply?

The Medium or Large business will decide. The business needs to form an opinion as to whether, if the personal services of the individual were provided under a contract directly between the individual and themselves, the individual would be regarded as an employee of the business. This is the same kind of employment status test based on case law that businesses and agencies have to consider when they hire staff directly. It is a matter of judgement whether the nature of, and manner in which, the services provided point to employment or self-employment.

HMRC has a Check Employment Status Service tool (CEST) to help businesses decide the status of individuals providing personal services to them. HMRC is currently working ‘to identify improvements to CEST and wider guidance to ensure it meets the needs of the private sector’. The link to the Employment Status Service tool is [www.gov.uk/guidance/check-employment-status-for-tax](https://www.gov.uk/guidance/check-employment-status-for-tax).

## Why have these rules been introduced?

HMRC have found it difficult to enforce their view of the applicability of the IR35 legislation to many PSCs. Many view the risk of being ‘caught’ by IR35, and thus being required to pay PAYE and NICs, is outweighed by the benefit of company profits being paid out under a ‘low salary, balance as dividends’ regime.

The new legislation therefore shifts the responsibility to the business receiving the services of the individual. This means that the risk of non-compliance falls onto the business.

**What can a contractor providing services through a PSC do if he or she disagree with the business deducting PAYE and NICs?**

The government will require the Medium or Large Business when it makes a status determination to:

* Communicate the decision to the worker in a Status Determination Statement (SDS), and
* Give the reasons for that determination if requested by the worker.

This will be in addition to communicating the decision to the party with whom the business has contracted; for example an agency.

The business must take ‘reasonable care’ in coming to its conclusion.

If disagreement with the decision arises there is an online tool to see if there is a different conclusion. This could lead to discussion of the results with the business. Many commentators consider the accuracy of the tool to be low and HMRC is currently working with stakeholders to enhance the service.

The government will introduce a ‘client-led status disagreement process’ so PSC’s can make a representation to the Medium or Large Business where there is disagreement with the conclusion mentioned in the SDS. The Medium or Large Business has 45 days, from when the representation is received, to review the decision and either confirm that the decision or give provide a different conclusion. If the business confirms the decision it must give its reasons for deciding that the conclusion is correct.

## What is the tax effect on a PSC?

The important point to appreciate is that the paying entity should send the contractor providing his or her services a P45 or a P60 showing the total payment and deductions in the 2020/21 tax year.

The amounts on the P45 or P60 must show as employment income on the employment pages of the 2020/21 self assessment tax return.

The amounts of income tax recorded as paid on the P45 or P60 may well not be the correct amount of income tax payable because initially a tax code ‘BR’ will be operated, which means income tax is deducted at basic rate. Employee NICs would be deducted at normal rates.

So there may be a tax repayment due if the personal tax allowance is not fully utilised against other income or income received from the medium or large business may attract a higher rate tax liability.

IR35 is complex, and many clients can find themselves wondering just what the rules mean in practical terms. We’ve written this guide to help develop your understanding of the legislation and what it means for you so please contact us to discuss your options.

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