

How to appeal wrongful tax treatment following an incorrect Off-Payroll assessment



Public sector contractors who have paid excessive amounts of tax as a result of being incorrectly assessed as 'inside IR35' under the [new Off-Payroll tax](#) have options should they wish to appeal.

[Chapter 10 of the Income Tax \(Earnings and Pensions\) Act 2003](#), introduced in the 2017 Finance Act, requires that public sector hirers assess the IR35 status, and determine the subsequent tax treatment, of their contingent workers.

The legislation also requires that employer's National Insurance (NI) and Apprenticeship Levy contributions are paid *on top* of the fee paid to the contractor by the party making the payment, in instances where the contractor is deemed to be caught by IR35.

Despite this, many contractors have been subject to incorrect IR35 status assessments and have had employer's NI deductions taken from their contract rates by hirers and agencies since the introduction of the Off-Payroll tax.

The employer's NI predicament and how to avoid it

Although several routes of appeal are available, contractors may only, in some instances be able to retrieve the overpaid income tax and employee's NI, as the employer's NI would typically be refundable to the fee-payer – which is either the agency or the hirer.

Contractors who have had employer's NI deducted from their contract rate will rightly view this as unjust. However, as tax and employment status expert David Kirk, of [David Kirk & Co](#), highlights, it provides an important reason for contractors to practice due diligence when approaching a new contract:

"The deduction of employer's NI from contract rates is a pressing issue and contractors need to take steps to ensure that they don't unwittingly enter into contracts with clauses permitting these deductions. Right now, hirers and agencies are finding workarounds and contractors are bearing the brunt.

"Contractors need to be completely clear about how they are going to be paid and how it will be calculated. If employer's NI forms any part of the calculation, it would suggest that the contractor will be paying it, not the client."

For contractors approaching a new contract, the message is clear; agencies should not be advertising contract rates that are inclusive of the hirer's employment taxes, in the same way that permanent salaries aren't either.

Addressing overpaid tax in your self-assessment tax return

Aside from informing contingent workers that they can challenge their tax treatment at tribunal, HMRC has also proposed that contractors address the issue within their self-assessment tax return, although this seems largely impractical.

“This would be an exceedingly messy way of dealing with things,” comments Kirk. “Also, it only addresses the overpaid income tax, not the employer’s NI which accounts for the vast majority of tax that most contractors believe they have overpaid.”

Further complexity is created by the matter needing consideration from both the perspective of the contractor and their limited company. The company would have to file its returns on the basis that there was no payment of salary, before deducting Corporation Tax from the net payment. The income tax deducted via Pay As You Earn (PAYE) could be treated as ‘doubtful debt’ until it is received.

Meanwhile, the contractor would have to display an employment page with PAYE deducted, but no income, and show the amounts paid to themselves as dividends, before explaining in the white space the reason behind the curious amendments.

“In practice, it is inconceivable that such a return wouldn’t trigger an inquiry,” explains Kirk. “Being a self-assessment inquiry, HMRC would be under greater pressure to complete it than when carrying out a standard IR35 compliance check, but the time taken could still be substantial.”

Taking the client to County Court

Alternatively, a contractor may decide to sue their client for the unpaid debt at County Court. However, this would put an end to any ongoing business relationship with the client and, as such, is only an option where the contractor and client have already cut ties.

This action could create considerable difficulties for both contractor and client. If the client fails to defend themselves properly, they could find themselves subject to a court order to pay the contractor, yet unable to recover the money from HMRC.

“Should the contractor win their case, they would be unable to treat the money as salary on which tax has been paid, as that would be contrary to their argument in court,” notes Kirk.

“Instead, it would be treated as profit, meaning the contractor may initially have to pay Corporation Tax on the sum if the case isn’t resolved by nine months after the accounting year end.”

He adds: “I would expect a County Court action to be resolved in time to deal with this, provided it was lodged early enough, but there is the risk of delays or an appeal.”

Applying to HMRC for a tax refund via section 8

Arguably, the most viable option would be for the contractor to apply to HMRC for a refund of employee’s NI paid in error, by way of a section 8 appeal.

“Under section 8(1)(a) of the [Social Security \(Transfer of Functions, etc.\) Act 1999](#), an officer of HMRC has the power to decide whether an individual is employed or self-employed,” explains Kirk.

“Regulation 52 of the [Social Security \(Contributions\) Regulations 2001](#) requires that HMRC returns NI paid in error to the worker. For this to happen, an application must be made to HMRC. This action would trigger a decision under section 8 as to whether the payment was made in error due to wrongful classification, following an internal review by a specialist HMRC officer.”

Kirk notes that any application would need to be made by the end of the tax year following the one within which the deductions were made. If HMRC fails to pay up or make a formal decision that no error was made within a reasonable time, the contractor can sue HMRC in the County Court, while any decision made by HMRC can also be appealed at tax tribunal.

“Though it isn’t guaranteed, I’m confident that this would be an option for contractors,” explains Kirk. “A contractor could initiate action as soon as the excess NI paid amounts to 1/15th of the contributions due at the upper earnings limit.

“This equates to £303, which would be payable on earnings of £10,952. While, in theory, this course of action is only applicable to NI, I can’t see that there would be a problem with HMRC applying it to tax as well.”

Changes needed to address client non-compliance

The measures highlighted might be enforceable in practice, but employer’s NI will still be refunded back to the fee-payer, even in instances where it has originally been deducted from the contractor’s income.

“The contractor and their company will have no rights to the employer’s NI at all unless it is written into their contracts that they are

responsible for paying employer's NI in the first place – which won't be the case," explains Kirk.

This issue stems from the Off-Payroll tax rules themselves, which Kirk acknowledges could be far more contractor-friendly: "Ideally, we would like to see the legislation amended to make the client liable for employer's NI in all instances. It wouldn't make the problem disappear altogether, but it would clamp down on it.

"I would encourage all contractors to get their [Off-Payroll consultation](#) responses in before 10 August and make the taxman aware of the magnitude of the situation. HMRC may not agree with the feedback, but it will be obliged to report it and pay attention to the issue."

But, while HMRC has a responsibility to ensure that non-compliance is minimised, Kirk also encourages contractors to take measures to protect their own interests:

"I would suggest that contractors get behind the idea of a law change so that the client pays the employer's NI. Then it would be their responsibility – end of story. Clients might lower contract rates to take account of this, but that would need to be done openly, and a contractor could always refuse the contract.

"Where possible, contractors should try to contract directly, as it creates more transparency. Quite often, the employer's NI gets passed down the supply chain when you have an agency in the middle."

In any case, contractors are advised to request a full breakdown of the rate being offered by the agency, or hirer, to decipher whether the rate quoted is inclusive or exclusive of the fee-payer's employment taxes. Failure to do so could see the contractor subject to effective tax rates that are considerably higher than those paid by employees.

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