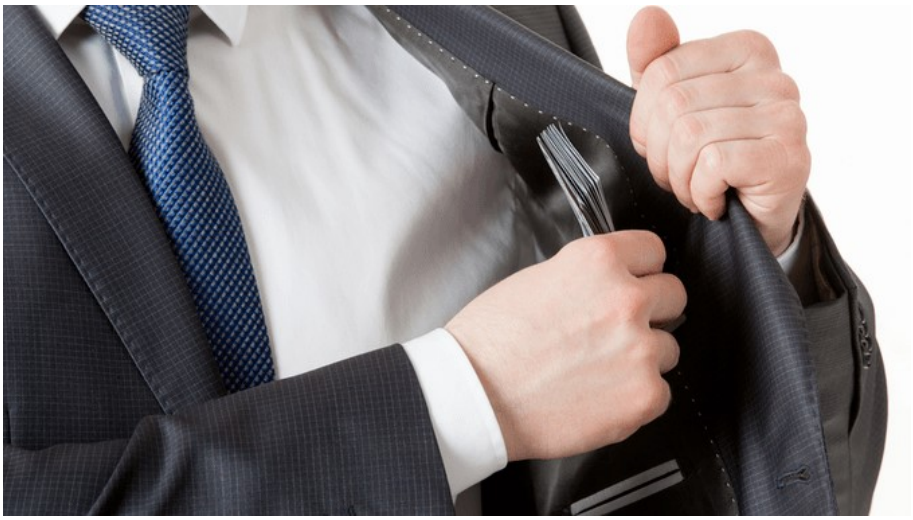
Employer's NICs – unlawful reverse chargebacks should be avoided



Reverse chargebacks imposed by recruitment agencies and umbrella companies on 'inside IR35' contract rates to fund employer's National Insurance Contributions (NICs) are unlawful and could constitute a criminal offence under the Criminal Finances Act (CFA) 2017.

However, any contractor seeking to prove criminality on the part of the offending party may encounter practical difficulties, as it would need to be proven that a dishonest action was undertaken to achieve a clear beneficial outcome.

This is according to tax barrister Alexander Wilson of Invicta Chambers, who observes: "Due in part to HMRC's somewhat ambiguous guidance, many offending parties could base a criminal defence around the argument that they simply misinterpreted the law. That is unless the contractor managed to secure proof of deliberate wrongdoing."

Avoid unlawful clauses from non-compliant agencies and umbrellas

Despite the 12-month delay of the Off-Payroll legislation, many medium and large end-clients are continuing to insist that their contractors engage via umbrella companies in the interim. As the market adjusts to the consequent imposition of employment tax liability on 'fee-payers', there are numerous reports of intermediaries adopting creative, yet dubious measures to offload said cost onto the contractor.

Many agencies are reported to have inserted clauses into contracts stating that, should an engagement be deemed 'inside IR35' by the client, the contract rate will be reduced by an amount comparable to the employment tax liability.

Meanwhile, for similar engagements, some umbrella companies are reported to have introduced additional fees payable by the contractor, typically amounting to 12.5% of the contract rate.

"It's effectively a double deduction, and the intention behind these clauses is clear," comments Martyn Valentine, director of The Law Place. "Some clauses are very brazen in stating that employer's NICs are to be deducted from the contract rate if deemed 'inside IR35'."

Employer's NICs deductions forbidden by law

The problem for recruitment agencies and umbrella companies introducing such clauses is that they constitute a clear breach of the Social Security Contributions and Benefits Act (SSCBA).

Whereas Schedule 1, Section 3(2)(a) of the SSCBA prevents companies from deducting their employer's NICs liability from earnings paid to an individual, Schedule 1, Paragraph 3A(1) offers further clarity on how the rules work in practice, stating:

'A person who is or has been liable to pay any secondary Class 1 contributions shall not –

> 1. *make, from earnings paid by him, any deduction in respect of any such contributions for which he or any other person is or has been liable;*
> 2. *otherwise recover any such contributions (directly or indirectly) from any person who is or has been a relevant earner; or*
> 3. *enter into any agreement with any person for the making of any such deduction or otherwise for the purpose of so recovering any such contributions.'*

According to Wilson, this forbids every possible measure that a company might attempt to apply to source employer's NICs from the worker, adding: "If any agreement or contract purports to cause such a deduction, the respective clause would be considered invalid.

"In fact, there is a risk that the whole contract could be torn up. Most contracts will have a clause stating that, if any clause is deemed unlawful or invalid, the remainder of the contract is still to be considered valid. But if a contract doesn't have such a clause, there could be a problem."

"Paragraph 3A(1)(c) is particularly important," adds Valentine. "This is what will trap umbrella companies who make deductions of class 1 employer's NICs."

Unlawful deductions could constitute a criminal offence

Whereas a County Court Claim for breach of contract should prove an effective means of recourse, striking out the clause and granting the contractor reimbursement of monies held back from them, breach of the SSCBA doesn't constitute criminality. This means awarding damages is an unlikely prospect.

Those seeking a sterner form of justice might consider their engagement in light of the CFA, on the grounds that less tax is collected as a result of the deductions made. Whereas the Off-Payroll legislation requires that the fee-payer pays employer's NICs *on top* of the rate paid to the contractor, deducting the tax liability from the contract rate means the tax is being collected from a diminished sum. This inevitably reduces the taxable income for Pay As You Earn (PAYE) and employee's NICs.

Wilson and Valentine both acknowledge that the fact that less tax is therefore collected could be perceived as tax evasion under the CFA, breach of which can be punishable by an unlimited fine.

Proving tax evasion could be problematic

However, proving criminality isn't a straightforward process. Section 45 sets out the criteria for a UK tax facilitation offence. Though Wilson, an ex-criminal practitioner, acknowledges that he could see how an offence could be committed, he observes that there are likely to be practical difficulties proving such:

"While the offence under section 45 is strict liability, there needs to be an underlaying tax evasion offence. That requires proving cheating the public revenue or fraudulent evasion. Both would require proving dishonesty.

"Unless there was a clear chain of emails demonstrating that this was deliberate - or other clear evidence - it would look like a simple misunderstanding of the law, rather than dishonesty. This is especially in the light of HMRC guidance, which could be more comprehensible."

Wilson adds: "Agencies, umbrellas and clients should be aware that if they worked together, or one of them knowingly allowed the other to deliberately pass the debt onto the contractor, thus reducing the amount of tax and NICs paid, a case could be built against them."

Contractors considering action advised to unite

A company can become subject to a claim for breach of the CFA either from the individual affected or from HMRC itself, as Valentine explains: "A claim for breach of the CFA would typically need to be brought by a contractor making a complaint to the Serious Fraud Office, or HMRC could bring a claim to the Crown Prosecution Service."

Due to the potential costs resulting from an unsuccessful claim, Valentine observes that any contractors seeking to make a claim would be advised to do so as part of a group action lawsuit, rather than pursuing their own case alone:

"If the claim is for more than £10,000 it is allocated to the Fast Track of the county court. If it's a group action it will almost certainly be sent to the High Court. The issue with litigation outside of the small claims and county courts, and the tribunals, is if the claimants lose, they will have to have reserve funds available to potentially pay the defendant's costs.

“So, I suppose this would make group actions by contractors similarly affected by these arrangements a more viable option. If they have enough protection from costs, such as insurances in place or accumulatively enough funds set aside to cover any adverse costs.”

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