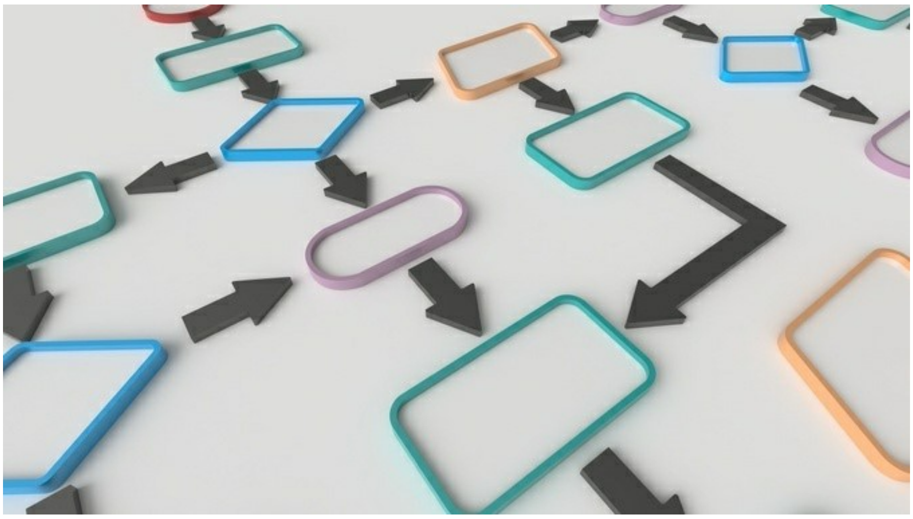
Off-Payroll audit guide: Understanding contractor operating structures



Understanding contractor operating structures is the essential first step towards achieving Off-Payroll compliance, and key to avoiding a lot of unnecessary administration.

If you are an end-client with no understanding of the operating structures used by the contractors you hire, you're not alone. With most contract engagements sourced through recruitment agencies, the lack of direct dealing between contractors and clients means this topic is rarely discussed. And why should it? It has been an insignificant detail to the end-client, until now.

With the Off-Payroll rules coming into force in April 2020, hiring organisations are now required to determine the deemed employment status of the limited company contractors that they hire. But not all contractors are limited company contractors.

Not all operating structures are relevant to Off-Payroll

Many end-clients are unaware that contractors undertake several different operating structures. The limited company – or personal service company (PSC) – is adopted by many contractors for multiple reasons. Limited company contractors enjoy benefits such as limited liability and the ability to claim pre-tax expenses on expenditure incurred in delivering their services to clients.

HMRC has imposed compliance requirements on clients and agencies to tackle what it claims to be abuse of IR35 by contractors working within scope of the rules while still enjoying preferable tax treatment. However, what the taxman has failed to acknowledge is that employer's National Insurance (NI) typically accounts for more than 80% of the perceived tax shortfall in such engagements, and would be payable by the hiring firm if the contractor were engaged as an employee.

Alternatively, many contractors opt to work either through umbrella companies or via agency payrolls. Whereas there are numerous reasons for doing so, one of which being the negation of administration associated with running a company, the fact that these contractors are paid via Pay As You Earn (PAYE) means they don't need to be considered under the Off-Payroll rules. This is because they are already paying the higher levels of taxes that accompany an 'inside IR35' status.

Remember, limited company contractors are the only ones who need to be considered in relation to IR35 and the Off-Payroll rules.

The problem with 'fearing the worst'

While many uninformed hiring organisations could wrongly perceive status assessments as a burdensome process, others fail to distinguish between contractors who need to be considered under the Off-Payroll rules and those who don't.

Firms probably won't necessarily have details of their contractor's operating structures to hand, but the inclination to fear the worst and assume that all workers are within the remit of the Off-Payroll rules is problematic. The issue is two-fold.

Firstly, it can create the perception that complying with the Off-Payroll rules is a far greater, and far costlier, task than it is. For example, a firm might engage 200 contractors, with 40 trading via a limited company and the remaining 160 working either via umbrella companies or PAYE agency models.

By failing to distinguish between operating structures, the client perceives the compliance burden to be five times greater than it actually is, prompting further unnecessary concerns over the impact on their budget.

This in itself can prove a deterrent from compliance, encouraging some organisations to blanket assess roles as ‘inside IR35’, with the resulting contrived arrangements often seeking to deduct the employment tax liability from the contract income. This is a non-compliant approach that ultimately puts a black mark next to the company in the eyes of many contractors, impeding its access to quality talent.

Secondly, failing to distinguish limited company contractors can create a lot of unnecessary work for organisations and ‘fee-payers’, in assessing the IR35 status and applying the relevant tax treatment to workers who ultimately aren’t within the remit of IR35.

The essential, and simple, first step to Off-Payroll compliance

End-clients can easily avoid all of this via an audit of their recruitment partners. This is the essential first step to achieving Off-Payroll compliance as it informs companies which contractors need considering with regards to the Off-Payroll rules, as well as helping to gauge the size of the task at hand.

All this entails is the creation of a spreadsheet sent out for recruitment partners to complete by inputting the details of each contractor’s operating structure. The spreadsheet should request details such as the contractor’s name and registration number and should be sent with a set date for completion and return.

Learn the Shield Passport Process

Firms can secure a more comprehensive overview of this, as well as the next steps to achieving Off-Payroll compliance courtesy of the Shield Passport Process (SPP). This workshop, designed by compliance experts IR35 Shield and Professional Passport, provides both clients and recruiters with a structured game-plan, helping them to navigate the Off-Payroll rules in a safe and compliant manner.

Recruiters can arrange for a workshop to be held at a location of their choosing, before inviting their clients to attend. If you would like an SPP workshop to be held at your organisation, then please get in touch.

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