

## Off-Payroll: 'assignment rates' pose problems for contractors, agencies and clients



Contractors engaging in 'inside IR35' contracts are advised to be aware of the term 'assignment rate' quoted by agencies, as the actual contract rate received could be considerably less.

In response to the Off-Payroll rules, some agencies and umbrella companies have engaged in non-compliant practices by unlawfully deducting employment taxes and other deductions from pre-agreed contract rates with contractors.

This is due to the confusion surrounding the concept of a rate commonly referred to as the 'assignment rate', which is not a PAYE salary-based rate. An 'assignment rate' actually includes the umbrella company's various costs, as well as accounting for the employment taxes which should be paid *on top* of the contract rate.

With the rules set to be extended to the private sector in April 2020, this is a problem which threatens to snowball, with competition within the recruitment industry only exacerbating the situation.

"Unfortunately, many agencies are failing to distinguish between the "invoice rate" - this is the rate paid to the umbrella company which covers the necessary costs – and the PAYE (Pay As You Earn) rate that contractors expect," explains Janet De-Havilland, CEO of [Pendragon Consultancy Ltd.](#) "This is largely because they are in competition for the contractors, which has driven some to advertise the invoice rates to entice contractors who later find that they don't receive the quoted rate."

### How employment taxes are accounted for under Off-Payroll

The Off-Payroll legislation is very clear regarding the tax treatment of contractors considered caught by IR35. [Chapter 10, Part 2 of the Income Tax \(Earnings and Pensions\) Act 2003](#), Section 61Q clarifies the calculation of the deemed direct payment, which for most 'inside IR35' contractors with no applicable expenses will simply be the agreed contract rate.

Elsewhere, Section 61N(3) states: *'The fee-payer is treated as making to the worker, and the worker is treated as receiving, a payment which is to be treated as earnings from an employment (the deemed direct payment).'*

Treating a payment as earnings from an employment simply means deducting PAYE income tax and employee's National Insurance Contributions (NICs) from the sum, while paying employer's NICs (13.8%) and the Apprenticeship Levy (0.5%) *on top* of this amount.

In law, the term 'employment taxes' refers to employer's NICs and the Apprenticeship Levy. However, HMRC frequently incorrectly uses this to refer to all of the taxes paid, generating confusion. To be clear, employee taxes are *deductions* from employment income, and employment taxes are paid *on top* of employment income.

Under the original IR35 rules, a contractor would have been expected to treat their pre-tax revenue as inclusive of employer's NICs, effectively subjecting them to a double NICs charge.

However, by making deductions for employment taxes as well as the umbrella margin, offending parties are breaching not only the Off-Payroll rules, but also the Social Security Contributions and Benefits Act 1992, [Schedule 1, Section 3\(2\)\(a\)](#) of which states:

*'No secondary contributor shall be entitled to make, from earnings paid by him, any deduction in respect of his own or any other person's secondary Class 1 contributions.'*

### **'Assignment rates': the risks for contractors, agencies and clients**

In the public sector, many agencies have circumvented their liability by deducting said costs from the advertised rate by referring to it as the 'assignment rate'. Contractors who have confronted agents over missing fees have been informed that the assignment rate is distinct from their contract rate, and that the fees paid are correct.

As De-Havilland observes, this is a misunderstanding of the rules by a lot of agencies and umbrellas which contractors can be forgiven for falling for: "If you enter a contract for which an 'assignment rate' is advertised at £15 per hour, you expect to receive £15 per hour for completing that assignment, subject to PAYE. Nobody expects to be advertised rates which are inclusive of costs that are supposed to be borne by the agency and umbrella company."

Though contractors are the victims, this arrangement also poses risks for agencies and umbrellas, several of whom have had successful civil actions brought against them by affected contingent workers. Though it will depend on the circumstances, and an umbrella company was required to pay the shortfall in a recent contractor win, De-Havilland believes that the agency will usually bear the greater risk of being targeted:

"I think the agency would be at greater risk because the umbrella company doesn't advertise for the work. As much as an umbrella may be complicit with the agency's wrongdoing, it still isn't responsible for the wrong rate being advertised to the worker. But umbrella companies can do better in clarifying from the start the rates agreed between parties."

As a relatively untested area of law, the consequences of abuse of the Off-Payroll tax calculation rules are uncertain. But, in deducting employment taxes from contract rates agreed with contractors, rather than making contributions *on top* of said fees, offending parties also diminish the amount of tax paid to HMRC.

There is a chance that this could be construed as failure to prevent tax evasion under the Criminal Finances Act 2017, in which case offenders risk an unlimited fine and a criminal record, if convicted.

### **Measures to curb abuse still a work in progress**

Government is aware of the issue, and has proposed measures to prevent exploitation through greater transparency. Industry bodies have lauded the 'Good Work Plan' proposal that agencies be required to produce a 'key information document' stipulating all deductions from a contractor's rate.

However, these proposals and other measures yet to be drafted into legislation, which has raised questions of the timing of the Off-Payroll rollout from Recruitment and Employment Confederation ([REC](#)) director of policy and campaigns Tom Hadley:

"Transparency in supply chains is key to ensuring that all agencies are working on a level playing field, and the REC has consistently raised this issue with Government. Some progress has been made with the introduction of the Good Work Plan.

"The introduction of IR35 in the public sector saw a marked increase in the number of umbrella companies. Although many umbrella companies are clear with their clients about fees, there are others who may not be as transparent.

"We therefore welcome Government's commitment to include umbrella companies under the remit of the Employment Agencies Inspectorate. However, this will need to be done as primary legislation. As such, we would like Government to delay the introduction of the Off-Payroll rules until 2021 to ensure the necessary regulation of umbrella companies is in place beforehand."

### **How umbrella companies can remain compliant**

The risk for non-compliant agencies and umbrella companies rises for every contractor subject to a so-called 'assignment rate' and will increase considerably more when the private sector Off-Payroll rules are introduced. For umbrella companies, the risk is not worth the reward, whereas compliance is remarkably straightforward:

"All umbrellas need to do is ask the contractor at the beginning of each contract what their job is, how many hours they work, and what

contract rate they are on. That's mandatory for an umbrella to know in any case. It also provides all the information they require to confirm whether the amount paid to them by the agency is enough to cover the contractor's rate as well as all associated employment costs.

"We always ask the contractor if the rate they have come to us with is the uplifted invoice rate or the PAYE rate. Once we've done the necessary calculations, if we don't think the rate has been sufficiently uplifted, we advise the contractor to go back to the agency. We will also communicate this to the agency ourselves."

"Good umbrella firms have a thorough on-boarding process in place that will explain everything to contractors regarding assignment rates, pay rates and deductions," adds Julia Kermode, CEO of the Freelancer & Contractor Services Association ([FCSA](#)). "Transparency is key, and without clear joined-up communication between agencies and umbrellas, misunderstandings may occur which could cause reputational damage."

Some umbrella companies will unfortunately encounter agencies that are unwilling to uplift insufficient rates, in which case the best option is to walk away, rather than rolling the dice with non-compliance.

## Agency compliance and the tax avoidance scheme risk

For recruitment agencies, compliance is even simpler. "All an agency needs to do is quote the PAYE rate for the contract," comments De-Havilland. "They don't need to do anything else, bar factoring in employment taxes and other necessary deductions into the separate invoice rate."

Unlike umbrella companies, the dangers of non-compliance for agencies aren't limited to civil action from contractors and concerns over the threat of tax evasion penalties. Agencies must also beware of tax avoidance schemes under the guise of 'umbrella companies'.

In the public sector, to avoid employment tax deductions from their rates, many contractors have unwittingly entered into tax avoidance schemes. These schemes often offer a similar net pay to the amount the contractor should have received following PAYE, making them difficult to spot.

"Since the Off-Payroll legislation hit the public sector we have seen a proliferation of schemes that aggressively target contractors to sell their product of higher take-home pay," says Kermode. "They 'work' by paying a small portion of contractors' earnings via PAYE and then disguising the remaining larger part of their income as something else, often an offshore loan. Most of these schemes are illegal, and any scheme that sounds too good to be true probably is."

As part of the private sector implementation, the Off-Payroll rules will grant HMRC license to pursue parties further up the supply chain for tax liabilities owed by non-compliant parties, should it not manage to retrieve the sums owed from the offending parties. As a result, inadvertently introducing a tax avoidance scheme into the supply chain poses a huge risk for agencies who, having incited the adoption of tax avoidance schemes, could be pursued by HMRC for debts owed.

Of course, this is also a risk for compliant agencies, albeit a significantly smaller one. Nonetheless, agencies will want to mitigate the threat by adopting a considerable level of transparency with umbrellas at the end of the supply chain. This may entail requesting copies of payslips sent to contractors or seeking indemnification from the umbrella company.

Contractors can also take measures to ensure that they aren't entering into a dubious arrangement. As Kermode highlights, there are numerous ways to spot a compliant umbrella company: "A true umbrella employs the worker whilst giving them flexibility to work for numerous end-hirers - so the worker has an umbrella of employment benefits and rights that they take with them wherever they work. Crucially, an umbrella will always pay 100% of your gross pay through RTI payroll."

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