

Off-Payroll (IR35) small company exemption vulnerable to exploitation, warns JSA



The [Off-Payroll rules' small company exemption](#) is at severe risk of being exploited by contractor clients in its current format, creating problems further down the supply chain. However, expected amendments to the rules could prove a barrier to company growth for some firms in the near future.

This is according to Chris James, head of accounting at [JSA Group](#), who notes that it is relatively simple for a company to find ways to meet the Companies Act 2006 definition of a small business:

"It's very easy for companies to continue to grow while finding ways to appear to meet the exemption, which will prove a nightmare for intermediaries in the supply chain tasked with reporting such information. However, if anti-avoidance measures are introduced, that is the point where some companies themselves may deem the exemption to be a bit of a barrier to growth."

Why will firms want to qualify for the small company exemption?

"It makes little sense to have a situation whereby a growing company has to consider whether, in a couple of years' time, it will have to revisit the way it manages its business, all because of the fact that it is set to surpass some arbitrary level of turnover," continues James.

Should Government press ahead with plans to introduce the small company exemption to the [Off-Payroll rules in the private sector](#), this will likely be the reality for many growing businesses who are heavily reliant on contingent labour.

The proposal means firms will be required to apply the Off-Payroll rules to their contractors, once they exceed two of the three thresholds used to define a [small business in the Companies Act 2006](#). These are:

- Annual turnover of up to £10.2m
- Balance sheet total of up to £5.1m
- Average number of employees of up to 50.

Given the administrative workload and cost that compliance with the Off-Payroll rules entails, there is a significant motivation for firms to meet this exemption.

Vague definition of what a small business is exposes loopholes

As James explains, this rather loose definition is vulnerable to manipulation by cunning hiring firms setting up what he refers to as 'small company special purpose vehicles':

"You would expect a company that engages a lot of contractors to exceed the turnover threshold. However, there is nothing preventing it from setting up a smaller subsidiary from which it offloads assets to keep its 'balance sheet total' – which is in fact its gross assets total – below £5.1m.

"That's not a difficult criterion to meet. Assuming the average number of employees is below 50 because the workforce is largely made up of contractors, two of the three thresholds have been met, meaning the company technically qualifies as small.

"There is a rule which basically states that a small company which heads up a large group of companies can't be considered small. But if the small company is merely a subsidiary beneath a larger group of companies, it's permissible," notes James. "The definition needs to be updated to amend this, or else it's an open invitation for companies to circumvent the rules."

Even having addressed the loophole, James acknowledges that there is nothing to stop firms from reducing balance sheet assets through measures such as selling assets and renting them back, or emptying company funds through the regular payment of dividends, adding: "These are all quite major things to do, but they are practically possible."

Exemption poses problems for agencies and HMRC

The exemption threatens problems for several parties involved. ContractorCalculator analysis of [HMRC's IR35 non-compliance cost estimates](#) suggests that the taxman believes roughly half of the perceived shortfall in the private sector comes from contractors engaged by small companies.

If it remains this easy for firms to secure small business status, it will hamper HMRC in its efforts to obtain its already questionable anticipated tax yield from the Off-Payroll rules.

"It would also appear that the party required to make the decision regarding the exemption is the agency directly below the end client in the supply chain, which creates further problems," comments James.

"The agency will presumably have to base their decision on what the client tells them, and many won't have the capabilities to know whether the information provided is correct. Of course, it's also in the client's best interests to be considered small, so the whole thing seems very difficult to apply in practice."

James adds: "We must also bear in mind the fact that HMRC expects this decision to be made for the current tax year. Where the small business definition is currently concerned, a company's accountant will provide them with information regarding their company size at their financial year-end. HMRC's expectation that agencies gather the necessary information from clients to make an accurate, up-to-date decision is not a realistic one."

Ill-conceived proposals threaten further exploitation of contractors

For James, the issues with the small company exemption are symptomatic of rushed and ill-conceived proposals. Another point of contention is HMRC's suggestion that clients should be responsible for administering an appeals process for contractors to dispute their deemed status. As James observes, rather than restoring balance, the proposal threatens to incite [non-compliance by way of blanket assessments](#):

"It doesn't make any sense really. The whole point of an appeals process was to ensure reasonable care is taken, and grant contractors a simple means of accessing justice.

"It's hard to believe that any disputed decisions will be overturned by an appeals process run by the very party which doesn't want to be on the wrong end of a successful appeal. Making the client judge, jury and executioner will surely result in widespread blanket assessments."

James acknowledges that there are commercial motivations for private sector firms to take reasonable care in conducting their assessments; namely offsetting the risk of losing contractors to other compliant companies. However, he warns that the rules are still very much geared so that many hirers will be encouraged to blanket assess:

"Where every contractor is deemed to be inside, there's no outstanding tax liability for HMRC to pursue. As a result, the end client perceives no risk, particularly if they are in charge of the appeals process. This is a fundamental flaw with the proposals."

James concludes: "This is unfortunately not too surprising. During both consultations and the external review, there was almost no focus on contractors, who are of course at the greatest risk of being exploited by anyone in the supply chain not doing the right thing."

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