

Off-Payroll (IR35) small company's exemption fraught with difficulty, says JSA



Proposals by HMRC – to include a small company's exemption from applying the Off-Payroll rules in the private sector – threaten to add further complications, while encouraging firms to circumvent the legislation.

This is according to Chris James, head of accounting at [JSA Group](#), who warns that the Government's proposed criteria for defining small businesses is far from black and white:

“The criteria intended to define small businesses might appear straightforward, but there are numerous factors which can tilt the balance one way or another, and which can confuse even a qualified accountant.

“The implications of Off-Payroll, in terms of administration and tax risk, may also mean some firms seek to exploit loopholes to maintain ‘small company’ status. HMRC needs to give some serious consideration to this when consulting on the proposals.”

Budget announcement promises small company exemption

Though Government announced its intentions in the 2018 Budget to extend the public sector Off-Payroll rules to the private sector, one notable concession was the exemption of small companies from the rules.

This exception came after respondents to HMRC's earlier consultation had warned of the unmanageable burden that the rules would place on UK firms, with smaller companies in particular expected to struggle to source the expertise required to conduct status assessments.

[HMRC's official consultation response](#) acknowledged this, noting that it had: ‘decided that for services provided to small businesses, the responsibility for determining employment status will remain with PSCs’. It added that Government intends to define small businesses using similar criteria to that found in the [Companies Act 2006](#).

Companies Act 2006: What is a ‘small company’?

The Companies Act 2006 sets out certain limits for a small company to operate within. These are:

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

“Be careful. ‘Balance sheet assets’ doesn’t mean the figure at the bottom of the balance sheet, which is net assets after the deduction of liabilities,” James explains. “Assets before liabilities are taken off is the figure you’re looking for.”

If a company meets two or more of these limits, they will likely be classed as a small company. However, James notes that it is important for firms to consider their figures for both the current and previous year:

“In some circumstances, if you breach two limits in one year, but met one or both of them the previous year, you may be granted a year’s ‘grace’ period before you have to accept that your company isn’t small.”

Group companies face further complications

There are further complications for companies that trade with other group companies, some of which fail to meet the ‘small company’ criteria, as James explains:

“If a small company heads up a group of companies that, when viewed as a whole, are not small, then that company cannot itself be considered small. There are also restrictions if a group contains listed companies, and special rules for calculating ‘average’ employee numbers. It’s perfectly possible for a ‘small’ company to be part of a ‘large’ group. It all makes for a pretty complex picture.”

Issues calculating average employee numbers won’t be aided by the fact that the companies in question typically engage numerous non-employee contractors and will likely have a very flexible approach to recruitment. With this in mind, James notes that he expects the criteria to be amended to include contract engagements.

Small company criteria at risk of exploitation

While resolving issues regarding average employee numbers may prove a relatively straightforward fix, preventing potential exploitation of the size criteria could prove a tall order for HMRC.

“It’s perfectly possible for a large group to contain individual companies that qualify as small under the Companies Act,” comments James. “So, what is to stop large businesses restructuring to enable the contractual ‘end-user’ to qualify as small, and be exempt from the rules?”

There are considerable motives for firms to exploit this opportunity, given that being required to apply the Off-Payroll rules incurs not only an administrative requirement but also tax risk. James notes that, to prevent restructuring, further amendments to the size criteria would be required, which itself would add further complexity.

Unintentional errors also pose a major risk, which, James notes, even accountants can be susceptible to, given the complexity of the situation:

“Deciding what size a company is guides what kind of accounts will be produced, how much detail and what kind of work is necessary. So, getting it right has cost and disclosure implications. I have known many accountants, who are much better at financial reporting technicalities than I am, get this wrong on a regular basis.”

Timing of size assessment may warrant additional rules

Companies currently use the size limits to determine their reporting requirements when preparing their accounts at year-end, meaning they work out the size of the company retrospectively and act accordingly.

The difference with the Off-Payroll proposal is that the company size will presumably need to be known during the current year, before all of the necessary facts and figures have become available.

“This will likely require another set of rules to follow, adding further complexity,” highlights James. “It might be sensible for firms to apply their company size status for the previous year to the current year. But, remember: the size rules already include the principle of a year’s grace, so it would effectively be extending this period by a further year.”

It is yet to be confirmed who will assume the responsibility for determining company size, but the Off-Payroll rules suggest that it will be the recruitment agency – where present in the supply chain.

“According to the Off-Payroll rules, the agency assumes the risk if it fails to deduct tax when it should have, so presumably it would be the agency’s responsibility to decide whether they are working with an exempt end-user,” comments James.

“This creates another additional administrative requirement for agencies to comply with. Whether HMRC considers easing this burden by

requiring firms to self-certify, awaits to be seen, but then we have the question of if the smallest end-users will have the nous to do so.”

James concludes: “Given these factors, it’s essential that the small company rules are simple to understand and apply. These are just a few of the issues that should be included in the upcoming consultation. It’s vital for the flexible workforce, and those who rely on them, that HMRC and the Treasury get it right.”

Published: 04 February 2019

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