TLT Reward, Resource, Retain

Resourcing contractors: the key tax points you need to know

Increasingly, businesses are adopting alternative resourcing solutions to traditional employee / employer relationships.

In this month's edition of TLT Reward, Resource, Retain we've set out the different types of engagements that exist with contractors, be it directly or through intermediary companies.

Our guide highlights key risks arising from those engagements and the legislative changes that will have an impact on you, as a client.

Engaging with limited companies

Personal Service Company (PSC)

The contractor is usually a director and shareholder of the company exercising management and financial control over it. If a contractor supplies their services through a PSC then, as a client, you will be under no obligation to account for tax in respect of that individual. Instead a tax rule known as IR35 will be relevant.

IR35 is aimed at stopping the avoidance of tax and national insurance contributions through the use of intermediaries (typically a personal service company) where but for the existence of the intermediary the contractor would in reality be considered an employee. If IR35 applies, the **PSC** is required to pay tax and national insurance through the PAYE system in relation to any fees paid for the contractor. It is the responsibility of the **PSC** to assess whether IR35 applies, although as a client you may be asked to confirm how the arrangement works in practice.

From April 2017, **employers** in the public sector **only** will need to assess whether IR35 applies and account for tax on payments made for the contractor's services.

Managed Service Company (MSC)

MSCs are also intermediary companies through which the services of a worker are provided to an end-user.

In contrast to personal service companies, the contractor in an MSC is, in HMRC's view, almost invariably not in business on their own account and is not exercising control over the business.

This control lies with the scheme provider. MSC scheme providers are businesses (usually companies) that provide these generic company structures and then administer the schemes.

If the MSC legislation applies, the **MSC** will be required to account for tax in relation to any fees paid for the contractor.

Again, as a client you will have no obligation to account for tax. However, unlike in the IR35 legislation, there are transfer of liability provisions that can apply in certain circumstances.

You should therefore be sure you **know what kind of entity you are engaging with**.

Engaging an individual directly

Are they in reality an employee?

Because you are engaging the contractor directly you will have to assess whether they are, in reality, an employee for tax purposes. You are at risk of penalties and fines if you do not account for tax correctly.

Key points

- Do you have a contract?
- Is it fit for purpose?
- Does it reflect what happens in practice?

Key employment tests

HMRC will take into account a number of factors in determining employment status including whether a contractor has to provide their own equipment, whether they receive holiday, maternity or sick pay or how they are paid. However, a lot of the focus will be on the following tests:

Control: Do you have a right of control over the contractor? What level of control do you exert over them, for example can you tell them where, when and how to carry out work?

Personal Service: HMRC notes that an essential element of employment is that the contractor provides personal service. Does the contractor have the ability to send a substitute, is this realistic (ie have you engaged the contractor for their particular skills)?

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Contractors supplied by other employment intermediaries

Agencies

Section 44 ITEPA: The "agency" legislation

The **employment agency** will need to consider whether s.44 ITEPA applies to the arrangements, if it does then the agency will be treated as the "deemed employer" of the contractor and they will need to account for tax in respect of the contractor.

Subject to certain conditions, the agency legislation applies where a contractor provides services to an 'employer' through a third party in such a way that, technically, the contractor is not an employee of either. The third party will often be an employment agency but the legislation may apply to any worker who provides services through any third party.

Risk: Be aware that if you contract with an offshore agency, in certain circumstances you can be liable for tax on fees paid to a contractor.

Contract with

PSC

Usually will fall outside of scope because of the way directors of such companies pay themselves although agency will need to assess that it is a genuine arrangement

Individuals

Assess whether:

- Tax already accounted for
- Supervision, direction or control **doesn't** apply

Risk: If you provide false or inaccurate information to the agency about the nature of your engagement with the contractor, the transfer of liability provisions in the legislation mean that you may be liable to account for tax in respect of that contractor.

Umbrella company

In an umbrella company arrangement, the worker is an employee of the umbrella company and is subject to tax and national insurance under PAYE. Therefore as a client you do not have to account for tax in respect of these individuals. The worker is not a director or shareholder of the company or involved in the running of the company in any way.

Changes to "travel and subsitence"

Previously, contractors working on a client site on a temporary basis were able to reclaim travel expenses tax free. However, due to amendments to legislation, where IR35 applies or the contractor supplied by an umbrella company is under **supervision, direction** or **control**, the client site is treated as the permanent workplace (travel to which does not attract a tax exemption). As such any refund of travel expenses will be treated as taxable, and such tax will need to be accounted for by the PSC or the Umbrella Company (as the contractor's employer). In these circumstances we have seen umbrella companies try to renegotiate fees with clients to offset the impact of the loss of this tax benefit.

Supervision: overseeing a person doing work ensuring that the work is being done and carried out to the required standard. Can involve helping the person where appropriate in order to develop their skills and knowledge.

Direction: making a person do work in a certain way by providing instructions, guidance or advice. Someone providing direction will often coordinate how the work is done, as it is being undertaken.

Control: dictating what work a person does, how they go about doing it and includes the power to move the person from one job to another.

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