

EXPLANATORY MEMORANDUM TO
THE INCOME TAX (PAY AS YOU EARN) (AMENDMENT NO. 3) REGULATIONS
2020

2020 No. 1150

1. Introduction

- 1.1 This explanatory memorandum has been prepared by HM Revenue and Customs (HMRC) and is laid before the House of Commons by Command of Her Majesty.
- 1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

- 2.1 This statutory instrument amends the Income Tax (Pay As You Earn) Regulations 2003 (S.I. 2003/2682) (the PAYE Regulations). Where a deemed employer has failed to make income tax deductions under PAYE from payments made to an off-payroll worker, and there is no realistic prospect of recovering the outstanding income tax from the deemed employer within a reasonable period, this instrument allows HMRC to recover the tax liability from other parties within the labour supply chain. These parties are the client for whom the work has been undertaken or the agency the client contracts with in the labour supply chain (the first agency), where that agency is based in the United Kingdom (UK).
- 2.2 This will encourage all parties to comply with the reformed intermediaries legislation and off-payroll working legislation set out in amended Part 2 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003) for engagements with public authorities and medium and large-sized organisations outside the public sector, enabling HMRC to collect all income tax that is due.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

- 3.1 This is the first exercise of powers under section 688AA of ITEPA 2003.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

- 3.2 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

4. Extent and Territorial Application

- 4.1 The territorial extent of this instrument is the United Kingdom.
- 4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

- 5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

- 6.1 Current law is included in Part 2 of ITEPA 2003. This was amended by the Finance Act 2020 so that, where a worker provides personal services to a medium and large-sized organisation outside the public sector (the client), that organisation will be responsible for assessing whether the worker would be an employee if engaged directly by the client. This change was introduced in the public sector by Finance Act 2017.
- 6.2 The PAYE Regulations govern the operation of the PAYE system under which income tax is deducted at source from payments made to employees and pensioners.
- 6.3 Under regulation 80 of the PAYE Regulations, where an employer has not accounted for or paid an amount of tax, HMRC may serve notice of a determination on the employer to collect the unpaid tax (regulation 80 determination).
- 6.4 These regulations insert new Chapter 4A into Part 4 of the PAYE Regulations to supplement the primary legislation by enabling HMRC to recover unpaid PAYE (income tax) liabilities from either the first agency or the client (in cases where the client is not the deemed employer).
- 6.5 The purpose of these regulations is to ensure that clients and first agencies, as the parties with the most power and influence in the labour supply chain, are accountable for any non-compliance that may occur in the labour supply chain where it results in unpaid PAYE liabilities.

7. Policy background

What is being done and why?

- 7.1 The off-payroll working reform is being introduced to improve fairness in the tax system by ensuring that individuals working like employees, but through a limited company or Personal Service Company (PSC), pay broadly the same income tax and National Insurance contributions (NICs) as individuals who are employed directly.
- 7.2 The regulations allow for HMRC to recover unpaid PAYE debts from other persons within the labour supply chain where Chapter 10, of Part 2 ITEPA 2003 applies to an engagement and there is no realistic prospect of recovering the outstanding income tax from the deemed employer within a reasonable period. When seeking to apply the regulations, HMRC will first seek to recover any unpaid tax liabilities from the first agency where this agency is based in the UK. Where HMRC are of the view that there is no realistic prospect of recovering the outstanding income tax from the first agency, HMRC will seek to recover unpaid liabilities from the client. The regulations require HMRC to issue a recovery notice when seeking to recover a debt from a client or the first agency.
- 7.3 There are two sets of circumstances in which HMRC may seek to issue a recovery notice. The first is where HMRC has issued a regulation 80 determination to the deemed employer and the outstanding tax remains unpaid. The second is where HMRC would have issued a regulation 80 determination, but is unable to do so because of the liquidation, dissolution or other incapacity of the deemed employer.
- 7.4 The regulations also provide for appeal rights for clients and the first agency in the labour supply chain, who have been issued a recovery notice. However, the recovery

notice cannot be appealed in relation to whether there is a PAYE debt if that matter has previously been the subject of an appeal that has been determined.

- 7.5 The regulations also include requirements for the contents of a recovery notice to help the client or first agency in the labour supply chain identify who the PAYE debt relates to and why it has been issued to them.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

- 8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

- 9.1 There are currently no plans to consolidate the instrument that is being amended.

10. Consultation outcome

- 10.1 At Autumn Budget 2017, the government announced plans to consult on how to tackle non-compliance with the off-payroll working rules in the private and voluntary sectors. Since then, the government has consulted extensively on the reform of the off-payroll working rules. The most recent policy consultation on the detailed design of the off-payroll working reform can be found at: <https://www.gov.uk/government/consultations/off-payroll-working-rules-from-april-2020>. The previous consultation on how to tackle non-compliance with the off-payroll working rules can also be found at: <https://www.gov.uk/government/consultations/off-payroll-working-in-the-private-sector>. Prior to this the government also consulted extensively on the public sector reform introduced in April 2017.
- 10.2 In response to feedback, the government announced that the reform would not apply to the smallest 1.5 million organisations, minimising their administrative costs. As a result of the consultation on the detailed design of the reform carried out in Spring 2019, a statutory requirement for clients to introduce a status disagreement process and to issue a Status Determination Statement providing reasons for the determination was provided for. Changes were also made to how liability transfers through the labour supply chain including in cases of non-compliance. HMRC published draft legislation in July 2019 for consultation.
- 10.3 On 7 January 2020, the government announced a review of the implementation of the off-payroll working reform. The purpose of the review was to identify any further steps the government could take to ensure the smooth and successful implementation of the reform. The outcome of the review was published in February 2020, announcing some changes to the policy and further support for businesses and individuals.
- 10.4 A draft version of this instrument was published for consultation on 22 January 2020 with the consultation closing on 19 February 2020 and can be found at: <https://www.gov.uk/government/consultations/draft-secondary-legislation-off-payroll-working-rules-from-april-2020>. 31 consultation responses were received. As a result, a number of changes have been made including: the time period within which a “recovery notice” must be issued by HMRC has been reduced from 24 months to 12 months; a requirement to include the details of the relevant workers to which the

recovery notice applies has been provided for; changes have been made to simplify and clarify language as appropriate.

- 10.5 The final primary legislation is included in Finance Act 2020. Throughout consultations and publication of draft primary and secondary legislation, the key founding principle of the client determining a worker's employment status for tax has not changed.

11. Guidance

- 11.1 HMRC has published detailed guidance to assist those preparing for the implementation. Relevant guidance on understanding the off-payroll working rules can be found at: <https://www.gov.uk/guidance/understanding-off-payroll-working-ir35>. Further guidance on how the off-payroll working rules should be applied can be found at: <https://www.gov.uk/topic/business-tax/ir35>.
- 11.2 HMRC continues to provide extensive support, education and guidance to help organisations implement the reform and apply it correctly. This includes factsheets and communications resources for businesses and workers, together with one to one engagement, workshops and webinars being provided to those affected. HMRC also developed an enhanced version of the Check Employment Status for Tax tool, which was launched together with guidance in November 2019.
- 11.3 Alongside this, detailed guidance has been published in the form of changes to the Employment Status Manual, which can be found at: <https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm10000> and includes specific sections on the recovery provisions.

12. Impact

- 12.1 The impact on business, charities or voluntary bodies is expected to be significant but varied, due to the scope of the off-payroll working rules and the degree of change required by this reform. These specific regulations may also have impacts on clients and the first agency as they allow HMRC to recover the unpaid debt from them where there is a failure by other parties below the client and first agency to account for PAYE tax liabilities.
- 12.2 More generally, affected client organisations will incur one-off and ongoing costs as a result of the reform. Up to 60,000 client organisations outside the public sector are in scope of the reformed rules, with the majority of large organisations, and a high proportion of medium-sized organisations, engaging off-payroll workers through agencies. One-off costs could include familiarisation with the changes, upskilling staff in making status determinations and determining whether the rules apply to their existing off-payroll engagements. Ongoing costs could include making status determinations for any new off-payroll engagements and maintaining a status disagreement process for off-payroll workers who seek to challenge their status determination. Some client organisations may find they are subject to a recovery notice for the unpaid PAYE debts where HMRC are unable to recover the debt from deemed employer or first agency.
- 12.3 Organisations that engage worker's intermediaries or PSCs directly will also be responsible for deducting tax and NICs and remitting it directly to HMRC for these engagements through Real Time Information (RTI).

- 12.4 Approximately 20,000 agencies who provide workers to medium or large-sized organisations will also be affected. They will need to operate payroll for any workers they supply who work through a limited company or PSC and fall within the scope of the rules. One-off costs could include familiarisation with the changes, upskilling staff and implementing processes that allow them to operate payroll on the payments made to PSCs. Ongoing costs for these agencies could include accounting for and reporting the PAYE liabilities through RTI returns. Some of these agencies will be first agencies. Where those first agencies do not already have deemed employer responsibilities to operate payroll for any workers they provide to client organisations, they may find they are subject to a recovery notice for the unpaid PAYE debts of other parties below them in the labour supply chain.
- 12.5 Some will realise savings through reduced administrative requirements. There will be ongoing savings for around 230,000 workers' intermediaries or PSCs, who will no longer have the requirement for determining the worker's status for tax purposes, or the associated accounting burdens.
- 12.6 The impact on the public sector is expected to include necessary action to address changes to improve the operation of the reform. Ongoing costs could include addressing new requirements to provide the reasons for a Status Determination Statement up front and maintaining a status disagreement process for off-payroll workers who seek to challenge their status determination.
- 12.7 A Tax Information and Impact Note covering this instrument was published on 11 July 2019 alongside draft legislation on the reform of the off-payroll working rules and is available on the website at: <https://www.gov.uk/government/publications/rules-for-off-payroll-working-from-april-2020>. Due to the delay to the implementation of the reform, an updated Tax Information and Impact Note will be published at the next fiscal event.

13. Regulating small business

- 13.1 The legislation applies to activities that are undertaken by small businesses.
- 13.2 To minimise the impact of the requirements on small businesses (employing up to 50 people), the approach taken is to exclude small businesses from having to determine whether or not a worker providing their services through an intermediary (such as a PSC) is subject to the off-payroll working rules.
- 13.3 Small agencies providing workers to clients within scope of the off-payroll working rules may be disproportionately affected by this change (as the measure will require them to place an off-payroll worker onto payroll). No specific action is proposed to minimise this regulatory burden. Small agencies that are also first agencies may also be affected where there is a failure by other parties below them in the labour supply chain to account for PAYE tax liabilities. No specific action is proposed to minimise this regulatory burden.
- 13.4 The basis for the final decision on what action to take to assist small businesses was that although small agencies may be disproportionately affected by this change, there are likely to be overall savings of £6.1 million per annum for PSCs who will no longer have the requirement for determining the worker's status for tax purposes, or the associated accounting burdens.

14. Monitoring & review

- 14.1 The measure will be monitored through information collected from tax returns, ongoing communications with affected taxpayer groups and through commissioning external research into the impacts of the reform six months after implementation.
- 14.2 The instrument does not include a statutory review clause. None is required under Section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015 because the power by which this instrument is made is being exercised so as to make or amend provisions imposing, abolishing or varying any tax duty, levy or other charge or provisions in connection with such provisions.

15. Contact

- 15.1 Şirin Geçmen at HM Revenue and Customs (email: sirin.gecmen@hmrc.gov.uk) and Jon Couzens (email: jon.couzens@hmrc.gov.uk) can be contacted with any queries regarding the instrument.
- 15.2 Christopher Simons, Deputy Director for the Off-Payroll Working Programme, at HM Revenue and Customs can confirm that this Explanatory Memorandum meets the required standard.
- 15.3 The Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.