

GUIDANCE TO DEPARTMENTS RESPONDING TO THE CHANGES TO THE OFF-PAYROLL (IR35) LEGISLATION

Action for Departments

This guidance note gives departments an overview of the likely numbers of contractors affected by the changes to the off-payroll rules, an update of the legislative position and outlines the considerations and actions that departments should be taking to respond to the challenges the changes present.

As a matter of priority departments should be looking to:

- 1) Using existing guidance that is available on gov.uk, re-examine all their contractor roles to understand whether they are within the scope of the off-payroll rules.
- 2) Consider reasons why a contractor is undertaking the role and whether any other resourcing or contracting options are available. This should include reviewing whether parts of the activity the contractor is undertaking could be done by permanent staff or if the contractor could be offered an appointment as an employee, in line with the rules on fair and open competition.
- 3) Following this exercise, to consider the individual contractor and their criticality, to determine whether any response is necessary to retain them.
- 4) Ensure the department is ready to make assessments of whether the off-payroll rules apply for new and existing contractors and track compliance with the legislation.
- 5) Work with Crown Commercial Service (CCS), agencies and payroll providers to ensure their readiness to calculate and collect tax and National Insurance Contributions (NICs) payments, including ensuring necessary commercial arrangements for such services are in place.
- 6) Communicating the changes clearly to contractors, staff managing contractors and external agency stakeholders.

Background and summary of the issue

Number of contractors impacted by the changes

From the data returns that departments have recently provided to CSHR our analysis shows that there are at least 6,000 contractors who are working in government departments operating through personal service companies (PSCs), across various frameworks. It is likely that a large proportion of these will be within the scope of the legislative changes, i.e. that they will be in scope of the off-payroll rules.

In some departments, there is a large and long-term dependency on contractors in the DDaT, PPM and commercial functions supporting the delivery of key

transformation projects. So that departments can effectively deliver the government's change agenda, we need to continue to attract the best contractors and to support them in their engagement.

The legislative changes

The revised legislation does not significantly alter the underlying tax liability of contractors. Instead it changes the way tax and NICs are collected to help ensure contractors pay the right amount of tax.

The changes mean that from 6 April 2017, the responsibility for the collection and payment of employment taxes and NICs for contractors working in government departments will transfer from the contractor's PSC to the public sector body or agency paying them. Government departments will need to ensure that contractors understand and comply with the appropriate legislation. This applies to individuals whose services are supplied through any government framework.

Impact on contractors within the scope of the off-payroll rules

Contractors who are in scope of the off payroll working rules are likely to have to pay additional tax and NICs, if they are not complying with the rules currently. Whilst each contractor's personal tax circumstances will vary, the changes may result in a significant reduction in net income for those who have not previously been compliant.

Risk of contractor attrition

There are concerns about contractor attrition. Whilst the actual volume of attrition has been small so far, billing arrangements and notice periods mean that many contractors will need to decide to stay or leave their roles in late February / early March, so an urgent and timely response is essential. It may be helpful to remind contractors that for those who are currently compliant with the rules, there should not be a significant impact on income.

We therefore need managers to make clear assessments as to whether the off-payroll rules apply to a particular contractor role and if they do, to be discriminating in their response to this. We ask that departments follow each of the steps below so that we can ensure a consistent response across government. Commercial, HR and finance teams will need to provide support to hiring and business managers in the implementation of this guidance.

1. Determining whether the off payroll working rules apply

Our **first priority** needs to be determining those contractors, who given the nature of their role, are in and out of scope of the off-payroll rules. We know that accurately defining contractor status can be complex but it is critical that departments do this. Only by doing this, can we target our response to address any risks the changes present.

Not all contractors will be within the scope of the off payroll working rules and some will be genuinely self-employed, and therefore out of the scope of the off – payroll rules. Guidance about contractors’ employment status and the existing employment status indicator is available from HMRC at: <https://www.gov.uk/employment-status/employee> and <https://www.gov.uk/guidance/employment-status-indicator>

As the legislation does not change the factors that determine whether a contractor is in scope of the off-payroll rules, departments should be using these existing resources to make indicative assessments of contractor status. If they need further assistance they should contact HMRC by emailing ir35@hmrc.gov.uk or calling 0300 123 2326.

We know that determining whether a contractor’s engagement is within the scope of the off-payroll rules is sometimes complex because several interrelated factors influence this. In reality, many assessments are more straightforward. We do need to ensure managers have an awareness of these factors so that they can understand whether the rules are likely to impact the contractor or not. This could influence how managers structure contractors’ work and may take the contractor outside of the off-payroll rules.

Someone is probably self-employed and outside of the off-payroll rules if most of the following are true:

- They are in business for themselves, are responsible for the success or failure of their business and can make a loss or a profit
- they can decide what work they do and when, where or how to do it
- they can hire someone else to do the work
- they are responsible for fixing any unsatisfactory work in their own time
- their employer agrees a fixed price for their work - it doesn’t depend on how long the job takes to finish
- they use their own money to buy business assets, cover running costs, and provide tools and equipment for their work
- they can work for more than one client at a time

Managers should be aware, that it is how the contractors’ engagement operates in practice that matters when considering these criteria. This is irrespective of any terms in their contract or, as mentioned above, the government framework through which their services are provided. It is possible for contractors who are both in and out of scope of the off payroll working rules to be engaged through CLOne (Capita), G-Cloud, DOS, NMNC and other frameworks.

HMRC will be providing a new on-line tool called the Employment Status Service (ESS) to assist in assessing whether contractors fall within the off payroll working

rules. The ESS will be available in early March. It is crucial that departments do not wait for this tool to become available and act swiftly to understand the status of their contractor base. The changes were originally announced at Budget 2016 so departments will have been preparing for some time.

Depending on the nature of the engagements, it is likely that in some areas, a large proportion of contractors will be within the scope of the off payroll rules. Departments should be planning on that basis.

Once a contractor's status has been assessed, departments must communicate that assessment to the contractor's agency. The agency will then communicate with the contractor. An assessment should also be made of whether new roles are in scope of the off-payroll rules prior to being advertised. We recommend that recruitment adverts state this.

2. Reviewing the resourcing or contracting model

Before departments consider any response to contractor attrition they must first consider reasons why a contractor is undertaking the role and whether any other resourcing options are available. This might include restructuring a department's resourcing model so that the contractor role can be deleted or potentially up skilling existing employees.

Appointment to a temporary or permanent Civil Service contract may be possible, potentially using the new DDaT reward framework or recruitment into the GCO where appropriate. Where there are vacancies available, these opportunities should be discussed with contractors. While departments may need to be flexible with headcount targets, there are potential cost savings resulting from this approach. Streamlined 'fair and open' recruitment can be used and there is possibility for flexibility to CS recruitment principles for some niche roles. The Civil Service Commission and CSR are happy to explore options with departments. Departments should be mindful of overarching employment law principles to ensure that for example, fixed term appointments should only be made when the role is 'truly' fixed term. Departmental HR teams can provide guidance on this.

For guidance on the terms of the DDaT and Commercial reward frameworks departments can contact civilservicepay@cabinetoffice.gov.uk. This team can also support submission of DDaT business cases to HM Treasury and navigating recruitment controls as swiftly as possible.

Departments may also consider whether the activities being provided by contractors can be revised. For example, is it possible for it to contract for provision 'of a service' rather than contracting 'for service'? Doing so, may mean the off-payroll rules do not apply. This broadly means, contracting for provision of a defined piece of work with specific deliverables and outputs, rather than for the

services of a particular person to work for the department in a similar way to employees. Departments must ensure they have appropriate structures and governance in place to work in this way as removing work activity from typical line and project management structures can increase costs and introduce risks.

3. Reviewing the criticality of the contractor role and managing the residual risk of contractor attrition

There are clearly significant presentational issues of government departments funding any rate increases for contractors to be seen to “offset tax losses”. This will, of course, only be an issue where contractors have not previously complied with the off payroll legislation. However, we recognise that there may be some particular circumstances where rates may need to be reviewed to retain critical resource. There will be no additional funding to departments to respond to the changes and they need to be managed in a cost neutral way.

If a contractor and the role they are undertaking, clearly falls within the scope of the off-payroll rules then an assessment of the criticality of the contractor role and the risk to business delivery is essential. This assessment should be made at an individual contractor level and should consider their performance in the role.

Hiring managers must discuss the contractor’s intention to stay with them. Permanent conversion or longer-term extensions to contracts beyond April may be attractive to some, offering role security. Hiring managers must also make it clear that by remaining in the public sector and having their tax affairs managed through payroll makes them compliant with the off-payroll rules. If it appears they are choosing to go and work in the private sector to simply maintain ‘outside of IR35 status’ you should consider informing HMRC, who may take action to investigate the contractor’s tax affairs further if they are seen as high risk.

Directly engaged contractors

If a contractor is directly engaged by the department, (i.e. not via an agency), departments are responsible for all aspects of the application of the legislation. This means that in addition to assessment of off-payroll status they must also make tax deductions through payroll and communicate with the contractor. As an alternative, contractors can be transferred to an agency where the correct deductions can be made. The CL One framework allows for such transfers.

Particular attention should be made where contractors have been resourced via GCloud, DOS or similar frameworks if they not operating via an agency but are in scope of the off-payroll rules. The department will be responsible for operating payroll for these contractors (unless they are transferred to an agency as noted above.)

Communications

We know that clear and co-ordinated communication is crucial. Departmental commercial teams should ensure that hiring managers understand the impact of the changes for their units and contractors and agree a consistent stance in responding to questions or requests for rate increases.

We have drafted template communications for unit / hiring managers and contractors setting out the current position. The letter should be sent to contractors once your department has determined a consistent response to the questions they may raise. **(See annexes A & B).**

Departments should also liaise with their ALBs to cascade messaging and monitor progress towards implementation.

HMRC guidance on the changes has been updated to reflect findings from the recent legislation consultation. The new employment status service, will be available in early March. HMRC's guidance is available at: <https://www.gov.uk/guidance/off-payroll-working-in-the-public-sector-reform-of-intermediaries-legislation>

Retrospective tax assessment

For those individuals who move to a compliant treatment, HMRC cannot guarantee that there will be no assessment of liability associated with their failure to operate the off payroll working rules for those employed in the public sector up to and including 5 April 2017. HMRC's focus is on ensuring compliance with the new rules in the public sector and improving it in the private sector. Contractors who move to work in the private sector and fail to comply with the off -payroll rules, risk investigation and, where appropriate, payment of any arrears and penalties.

Contract and Framework Review

CCS is reviewing its contingent labour contracts with a view to adding clauses (if necessary) to cover the new legislation from a contractual perspective. CCS is also creating a procurement policy note to give guidance to departments who have their own contract frameworks and the wider public sector. Please see: <https://www.gov.uk/government/collections/procurement-policy-notes>

Annex A

Reform of the off-payroll rules for contractors that operate through an intermediary – Update for Business Units and Hiring Managers

Background

In the Autumn Statement 2016, the Chancellor of the Exchequer confirmed plans to reform the off payroll working rules for the public sector (often referred to as 'IR35'). These changes are due to come into effect from 6 April 2017. The main change for [the department] is that, from April 2017, the responsibility to pay employment taxes will shift from the contractor's personal service company (PSC) to the public sector body or agency that pays the contractor's fees. The off payroll rules were introduced in 2000 to ensure that people who provide their services through their own limited company but who would be employees if they were directly engaged, paid broadly similar levels of tax as other employees. However, there is widespread non-compliance with the current rules and the reforms are designed to ensure that they work more effectively. This presents some challenges because of the contrast with the position in the private sector, where the rules are unchanged. However, the impact of the changes will primarily be on those contractors who are not complying with the current off payroll working rules.

Impact to the Department

At a high level, there will be about [number in department] of contractors in post at the end of March.

Our first priority is to determine those contractors, given the nature of their role, who are in and out of scope of the off-payroll rules. Accurately defining contractor status can sometimes be difficult and it is critical that we utilise existing resources to do this as far as possible. One of the tests for whether or not the off payroll working rules apply is the normal employment status test. This involves looking at the way the worker performs services for the department and determining whether, if it were not for the existence of their PSC, they would be working for us as an employee.

Not all contractors will be within the scope of the off payroll working rules and some will be genuinely self-employed. You can find guidance about contractors' employment status and the existing employment status indicator is available from HMRC at: <https://www.gov.uk/employment-status/employee> and <http://tools.hmrc.gov.uk/esj>. As the legislation does not change the factors that determine whether a contractor is in scope of the off-payroll rules, you should use these resources to make indicative assessments of contractor status. If they need further assistance they should contact HMRC by emailing ir35@hmrc.gov.uk or calling 0300 123 2326. [Relevant department contact can also provide support]

We know that determining whether a contractor's engagement is within the scope of the off-payroll rules is sometimes complex because several interrelated factors influence this. Someone is probably self-employed and outside of the off-payroll rules if most of the following are true:

- They are in business for themselves, are responsible for the success or failure of their business and can make a loss or a profit
- they can decide what work they do and when, where or how to do it
- they can hire someone else to do the work
- they are responsible for fixing any unsatisfactory work in their own time
- their employer agrees a fixed price for their work - it doesn't depend on how long the job takes to finish
- they use their own money to buy business assets, cover running costs, and provide tools and equipment for their work
- they can work for more than one client at a time

It is important to note that it is how the contractors' engagement operates in practice that matters when considering these criteria. This is irrespective of any terms in their contract that allude to them applying in a particular way.

HMRC will be providing a new on-line tool, the Employment Status Service (ESS), to assist in assessing whether contractors' fall within the off payroll working rules. This will be available in early March. It is crucial that we do not wait on the availability of this tool and act swiftly to understand the status of their contractor base. You should note that the framework through which a contractor is engaged has no bearing on whether or not they are in scope of the off payroll working rules. It is possible for contractors who are both in and out of scope of the off payroll working rules to be engaged through CLOne (Capita), G-Cloud, DOS, NMNC and other frameworks.

There will be a narrow timeframe between the launch of the employment status service and the introduction of the reforms; this is a risk factor and makes clear and timely communication of the changes vital.

[Department to insert understanding of key areas of business / functions impacted – numbers – greatest risk etc]

Responding to the Issue of the attrition of contractors

We know that there have been reports that a high proportion of contractors may wish to leave as a result of the changes and we need to manage our response to this issue consistently across all government departments and business units. In fact, for those who are currently compliant with the rules, there should not be a significant impact.

We therefore need managers to make clear assessments as to whether the off-payroll rules apply to a particular contractor role and if they do, to be discriminating in their response to this. You must first consider reasons why a contractor is undertaking the role and whether any other resourcing or contracting options are available.

This might include restructuring your resourcing model so that the contractor role can be deleted or potentially up skilling existing employees. Appointment to a temporary or permanent Civil Service contract may be attractive to some, potentially using the new DDaT reward framework or recruitment into the GCO where appropriate. Where there are vacancies available, these opportunities should be discussed with contractors. **The [HR team] is able to support understanding these options.**

You may also consider whether it is possible to contract for provision of defined pieces of work with specific deliverables and outputs, rather than for the services of a particular person to work for the department in a similar way to employees. If you are considering this approach, you must ensure that you have appropriate structures and governance in place. Removing work activity from typical line and project management structures can increase costs and introduce risks. **The [commercial team] is able to support in considering this option.**

If a contractor is clearly within the scope of the off-payroll rules, then you need to assess the criticality of their role and the risk to business delivery. This assessment should be made at an individual contractor level and should consider their performance in the role.

You must discuss the contractor's intention to stay with them. Longer-term extensions to contracts beyond April may be attractive to some, offering role security. You must also make it clear that by remaining in the public sector and having their tax affairs managed through payroll makes the contractor compliant with the off-payroll rules.

There are significant presentational issues with government departments funding any rate increases for contractors to be seen to "offset tax losses", where contractors have not been complying with the tax rules. There will be no additional funding from central department budgets hence we must be prudent with the application of any rate increases and must be ready to absorb the cost of such increases.

We are aware that many workers' contracts may end by 31 March 2017, this together with billing processes mean they are likely to decide whether they

plan to stay in late February / early March. [Note about departmental process for monitoring contractor behaviour / attrition.]

Communications

We need to manage communications carefully to limit contractors taking 'knee jerk' reactions. I would be grateful if you could send the draft email to contactors in your business unit as soon as possible.

There is also the following communication activity planned [Review according to departmental plans, this is suggested as good practice]:

- HMRC has launched an off-payroll working in the public sector page at <https://www.gov.uk/guidance/off-payroll-working-in-the-public-sector-reform-of-intermediaries-legislation>
- Available from the page is guidance for fee-payers, PSCs and public authorities to use, and links to material such as the draft tax and NICs legislation and the technical note. This gov.uk page will be updated with further information, including the link to new Employment Status Service, as these become available. [Workshop with HR Business Partners to increase awareness of project and discuss how to achieve value-for-money from contingent labour.]
- Conference call Q&A for all contingent workers
- January-February 2017 – HMRC will be testing the online tool, ESS, before making the tool available in early March 2017.
- April 2017 - a further letter to all workers affected, ensuring they are complying with the new arrangements.

Annex B – Draft note to contractors

Dear Colleague,

As you know, from 6 April 2017, as a contractor employed through an intermediary such as your own personal service company (PSC), you may be affected by changes to the way the off payroll working rules (IR35) are applied. This will mean the responsibility for paying employment taxes and National Insurance Contributions (NICs) will shift from your PSC to your engaging organisation, either your agency or [department name].

Firstly, I want to make it clear that the role you are undertaking makes a valuable contribution to the department and I realise you may be wondering what the changes will mean for you and your role. We are committed to ensuring that the changes are introduced in a clear and transparent way. The first stage is to understand whether your role will fall in scope of the off payroll working rules. Whilst accurately defining contractor status can sometimes be complex, in the majority of cases, existing HMRC guidance enables an accurate indicative assessment. The new Employment Status Service will be available in early March. In the short term we want to ensure that you understand the implications the legislation has for yourself.

The off payroll rules were introduced in 2000 to ensure that people who provide their services through their own limited company but who would be employees if they were directly engaged, paid broadly similar levels of tax as other employees. However, there is widespread non-compliance with the current rules and the reforms are designed to ensure that they work more effectively. The reformed legislation does not change your underlying tax and NICs liability but it will ensure that all contractors working for public sector bodies operate in a tax compliant manner. In fact, for those who are currently compliant with the rules, there should not be a significant impact on income.

Continuing to work in the public sector and paying employment taxes through the payroll will mean that the compliance responsibilities for the off-payroll rules now rest with the organisation that pays you. This will help ensure everyone pays the right amount of tax and NICs. These changes are an important part of HMRC's continued efforts to deliver a fairer tax system. They are tightening their scrutiny of contractor pay arrangements across the private and public sectors. The changes to the way the off-payroll rules are applied within the public sector will remove the risk of falling foul of tax rules them and reduce the opportunities for error in the operation of the rules.

If you are a director or partner of your own limited company, you are currently responsible for deciding if the off-pay roll rules apply to each of your

engagements and for ensuring that the correct tax is paid accordingly. There can be significant consequences if you do not do this correctly or ignore relevant legislation such as the off payroll rules. Interest and penalties can be charged on any extra tax and NICs that are owed. Penalties can be more severe if it can be proved that you have deliberately ignored the rules. As a government department we have a responsibility to ensure full compliance with legislation.

We are currently [departmental / functional explanation of approaches being taken which might refer to mechanism to review contactor resource.]

there is guidance available at:

<https://www.gov.uk/guidance/off-payroll-working-in-the-public-sector-reform-of-intermediaries-legislation>

We continue to recognise that by engaging with contractors [department] can attract some of the very best talent to deliver against the government's transformation agenda and [department specific projects.] The unique and specialist skills of contract and interim staff are a valued part of our workforce.

If you have any questions, please do contact [department manager / commercial]