

New Obligations for Businesses Operating in the UK and Engaging UK “Consultants” from April 6, 2021

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The United Kingdom (U.K.) currently operates certain off-payroll working rules (commonly referred to as IR35), which subject certain individuals (often operating as consultants to businesses) working through intermediaries (such as their own personal service companies) to employment taxes. Under these rules, the intermediary is responsible for assessing whether IR35 applies. Her Majesty’s Revenue and Customs (HMRC) believes that this allocation of responsibility to intermediaries is giving rise to serial noncompliance, which will cost the U.K. £1.3 billion a year by 2023/24. As such, the U.K. has introduced new rules designed to shift the responsibility for operating IR35 from individuals, and their intermediary vehicles, to the organizations (with U.K. operations) they provide their services to, effective from April 6, 2021. It is therefore important for all businesses with a U.K. presence and working with U.K. consultants operating through intermediaries (such as personal service companies (PSCs)) to take immediate steps to prepare for the implementation of these rules.

In April 2017, the U.K. introduced new rules (described herein as the “off-payroll working rules”) designed to ensure that individuals engaged by public sector organizations were taxed akin to employees if the services they provided were akin to those of an employee. Despite persisting concerns with those rules, the U.K. government has committed to extending the off-payroll working rules to medium- and large-sized businesses operating in the private sector, effective from April 6, 2021.

The new rules create additional obligations for medium- and large-sized businesses, which will be required to (i) carry out due diligence on their supply chains in order to establish whether employment taxes must be withheld from payments made to individuals acting through intermediaries, (ii) submit statements to those individuals reflecting their determinations and (iii) potentially, withhold employment taxes on payments made to those intermediaries.

In particular, investment managers with U.K. operations, who work with U.K. tax resident consultants, are likely to fall within the scope of these rules and should take steps to confirm whether relationships between consultants and portfolio companies need to be adjusted to accommodate the new rules.

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A brief overview of the rules, and how they could affect your business, has been set out below.

What Do the New Rules do?

HMRC has long argued that intermediaries, such as PSCs, heavily underreport deemed employment income under IR35. To tackle noncompliance, the U.K. intends to push the compliance burden on to the organizations the intermediaries provide their services to (the “Business”), which should be able to independently assess whether the individual is in fact performing a role akin to an employee. If an individual is treated as performing a role akin to an employee, payments made to that individual’s intermediary could be subject to U.K. employment taxes.

Who Do They Apply To?

The rules apply to all medium- and large-sized businesses with a U.K. connection to whom services are provided by an individual through an intermediary (such as a PSC). Small businesses engaging individuals through intermediaries are exempt from the new rules (in which case, the intermediary will still be required to operate under the existing IR35 rules). A business is treated as medium or large if it fails two or more of the following conditions:

1. Its turnover is no more than £10.2m.
2. Its balance sheet total is no more than £5.1m (relevant to companies only).
3. It has no more than 50 employees (relevant to companies only).

There are also special construction rules for entities forming part of a group.

The off-payroll working rules will not apply to Businesses with no U.K. connection. A Business will be treated as having no U.K. connection for these purposes if it is not resident, and does not have a permanent establishment, in the U.K.

What Do Businesses Have to Do?

Making the Assessment

In order to make an assessment, a Business must:

1. Review all existing and any future arrangements with suppliers to determine whether services provided to it by an intermediary (including a PSC) relate to services personally performed by an individual.
2. Determine whether such services relate to an arrangement that, if contracted directly between the individual and the Business, would represent an employment relationship or otherwise relate to the provision of services by an office-holder (such as a non-executive director) in his or her capacity as such, for tax purposes.

Once the Business has reached a view on the individual’s IR35 position, it must prepare and submit to the individual (and any intermediaries) a “status determination statement” confirming the determination it has made in respect of that individual, as well as the basis on which it has reached that decision (which could be appealed by the individual).

Withholding Employment Taxes

If the Business is making payments directly to the intermediary of the individual and it determines that the activities of the individual represent an employment relationship or activities of an office-holder subject to U.K. employment taxes, the Business will be required to withhold employment taxes from payments made to the intermediary. If there are other parties within the payment chain, the primary obligation may fall on another party, though the obligation to withhold may revert to the Business in certain circumstances.

What Does This Mean for Investment Managers?

The rules are expected to apply to any deemed employment relationship or office-holder to the extent that such person is a U.K. tax resident (and subject to U.K. taxes on income arising to that person). In many cases, investment managers contracting with special advisers or consultants based in the U.K. and acting through companies, partnerships or other intermediary vehicles will need to apply these rules to the services they receive from the intermediary.

Investment managers will also need to be aware of the rules if fund investment assets include U.K. portfolio companies, particularly if any of the directors (including non-executive directors) are currently treated as consultants operating through an intermediary.

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