EXPLANATORY MEMORANDUM TO

THE INCOME TAX (PAY AS YOU EARN) (AMENDMENT NO. 2) REGULATIONS 2020

2020 No. 373

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.

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).

2.2 Where a worker (off-payroll worker) provides personal services through the worker's intermediary to a public authority (the client), the public authority is responsible for assessing whether the worker would be an employee if engaged directly by the client. Once the employment status of the worker is assessed by the client, the client, agency, or other third party paying the worker's intermediary for the worker's services is treated as an employer (the deemed employer) for the purposes of tax and Class 1 National Insurance contributions (NICs) for that individual. This instrument amends the PAYE Regulations to provide for the reporting of an off-payroll worker indicator on PAYE Real Time Information (RTI) returns submitted to HMRC. All deemed employers will be required to complete the indicator whenever a payment is made in respect of an off-payroll worker who is subject to the public sector off-payroll working rules implemented from 6 April 2017.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

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 Chapters 8 and 10, of Part 2 of the Income Tax (Earnings and Pensions) Act 2003. These Chapters make sure that individuals working like employees, but through a limited company, partnership or other individual (the worker's intermediary or personal service company (PSC)), pay broadly the same income tax and NICs as individuals who are employed directly.

6.2 The PAYE Regulations govern the operation of the PAYE system under which income tax is deducted from payments made to employees and pensioners.

6.3 Schedule A1 to the PAYE Regulations specifies the information that is to be reported to HMRC when payments are made to employees.

6.4 Where a worker provides services personally to a public authority (the client), that organisation is responsible for assessing whether the worker would be an employee if engaged directly by the client. Once the employment status of the worker is assessed by the client, the client, agency, or other third party paying the worker's intermediary for the worker's services is treated as an employer for the purposes of tax and Class 1 NICs for that individual. The deemed employer is obliged to make payments to HMRC and to send HMRC information about any payments made using RTI returns. These regulations require deemed employers to complete an off-payroll worker indicator on PAYE RTI returns whenever a payment is made in respect of an off-payroll worker who is subject to the off-payroll working rules in the public sector introduced on 6 April 2017.

7. Policy background

What is being done and why?

7.1 The off-payroll working rules in the public sector were introduced to improve fairness in the tax system by ensuring that individuals working like employees, but through a limited company, partnership, other individual, or PSC, pay broadly the same income tax and NICs as individuals who are employed directly.

7.2 In preparation for wider roll out of the public sector reform to the private and voluntary sectors, in response to stakeholder feedback, the government considered that the introduction of an off-payroll worker indicator would be helpful for the implementation of the reform and to ensure the impact of the wider reform could be evaluated and assessed. The government announcement to delay implementation of the reform in the private and voluntary sectors until April 2021 due to the impacts of the Covid-19 pandemic, means that the information technology changes are not necessary for those sectors until April 2021.

7.3 However, the requirement on deemed employers for engagements in the public sector to complete an additional indicator enables HMRC and external information technology systems to automatically deregister off-payroll workers subject to the public sector reform from inadvertently and incorrectly being subject to student loan payment deductions, which should instead be dealt with through the self-assessment system. It will also prevent unnecessary and incorrect automatic prompts to deemed employers to make student loan payment deductions where they should not be doing so.

7.4 The inclusion of the indicator from April 2020 will also provide an opportunity for the data and information received in relation to the public sector reform to be tested and evaluated.

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 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 from April 2020 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 A draft version of an instrument including this measure and provisions to recover unpaid deemed employer PAYE debts from third parties in the labour supply chain 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. This instrument only provides for the inclusion of the off-payroll worker indicator in terms of changes to the PAYE regulations.

10.3 Following a government announcement on 17 March to delay the implementation of the off-payroll working rules in the private and voluntary sectors until April 2021, the government is not introducing the provisions to recover unpaid deemed employer PAYE debts from third parties at this stage.

10.4 None of the consultation responses received raised any specific concerns about the indicator, therefore no changes have been made to the requirement to report payments made to off-payroll workers in the public sector.

11. Guidance

11.1 HMRC has published detailed guidance throughout the consultation periods for this reform in order 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 has and continues to provide extensive support, education and guidance to help organisations implement the reform and apply it correctly. Since the public sector reform a factsheet on the reform was published at Budget 2018 and republished with

updates related to the draft legislation published in July 2019; guidance on how businesses can prepare for the changes was published in April and August 2019; an enhanced version of the Check Employment Status for Tax tool was launched together with guidance in November 2019; a further factsheet that affected organisations could provide to their workers was also published, together with one to one support, workshops and webinars being provided to those affected by the changes.

11.3 Alongside this, detailed draft 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. The Employment Status Manual will be republished with any necessary further changes once Finance Bill 2020 receives Royal Assent.

12. Impact

12.1 The impact on business, charities or voluntary bodies is expected to be limited as the off-payroll working rules in the public sector have been in place since April 2017 and only applies to public authorities as defined by the Freedom of Information Act 2000 and Freedom of Information Scotland Act 2002.

12.2 The impact on the public sector is expected to be minimal. Public sector organisations should already have processes and procedures in place to operate PAYE RTI returns for those off-payroll workers that they contract with directly through the worker's intermediary. For engagements where there is an agency within the labour supply chain, again these agencies should already have processes and procedures in place to operate PAYE RTI returns for the off-payroll workers they supply to public sector organisations.

12.3 The minor additional requirement to identify off-payroll workers subject to the public sector reform on RTI returns is expected to have minimal impact, as the correct completion of the indicator enables HMRC and external information technology systems to automatically deregister off-payroll workers subject to the public sector reform from inadvertently and incorrectly being subject to student loan payment deductions. It will also prevent unnecessary and incorrect automatic prompts to deemed employers to make student loan payment deductions where they should not be doing so.

12.4 A Tax Information and Impact Note (TIIN) covering this instrument was published on 11 July 2019 alongside draft legislation on the off-payroll working rules originally due to take effect from April 2020 and is available on the website at https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins. It remains an accurate summary of the impacts that apply to this instrument.

12.5 This TIIN also covered the extension of the public sector reform to the private and voluntary sectors which has been delayed to 6 April 2021. However, the introduction of off-payroll working indicator was factored in to considerations for the wider reform for use in all sectors.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 No specific mitigating action is proposed to minimise regulatory burdens on small businesses. Small agencies providing workers to clients within scope of the off-

payroll working rules in the public sector may be disproportionately affected by this change (as the measure will require them to take a minor additional action for existing PAYE RTI obligations for payments made to deemed employees).

13.3 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, the additional action needed is minor and will take place during the carrying out of existing obligations.

14. Monitoring & review

14.1 The measure will be monitored through information collected from tax returns and ongoing communications with affected taxpayer groups.

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 The HM Revenue & Customs email: offpayrollworking.legislation@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.