Off-payrolling for the public sector

Significant changes in the tax treatment of contractors working in the public sector were introduced from 6 April 2017. One issue that is not particularly clear is the accounting treatment of the PAYE levied on the payment to the intermediary.

Example

Mark Ltd is paid £100,000 by HMRC in relation to a public sector contract which is caught by the new rules. £30,000 PAYE and NIC is deducted at source. The company has other expenses of £5,000.

Accounting treatment

In relation to the company, turnover must equal the amount billed of £100,000. The £30,000 is treated as a cost of sale. The company has other expenses of £5,000, so the accounts show a healthy profit at this stage of £65,000, which is the retained cash.

Application of the income tax Acts in relation to deemed employment

The tax and PAYE rules apply as if the worker were employed by the person treated as making the deemed direct payment and the services were performed, or to be performed, by the worker in the course of performing the duties of that employment.

Example continued

Consequently, the £100,000 less the associated £30,000 will appear on the employment pages of Mark's personal tax return for 2017/18 unless he wishes to dispute the deemed employment status.

Extraction

There is then the issue of extracting the £65,000 cash from the company which has already been subject to PAYE. The cash must be taken out legally from a company law perspective, which really leaves two options.

Option 1 is to take the money out as salary, which will give a deduction in the accounts.

Option 2 is to take the money out as a distribution, which will not give a deduction in the accounts.

There appears to be no option 3 of a loan account withdrawal as there is nothing to credit against the account.

Prevention of a double charge to tax and the allowance of certain deductions

The tax rules then state that where a person:

- receives a payment or benefit ('the end-of-line remuneration') from another person ('the paying intermediary');
- the end-of-line remuneration can reasonably be taken to represent remuneration for services of the payee to a public authority;
- a payment ('the deemed payment') has been treated as made to the payee;
- the underlying chain payment can reasonably be taken to be for the same services of the payee to that public authority; and
- the recipient of the underlying chain payment has borne the cost of any PAYE and NIC in respect of the deemed payment.

Then the paying intermediary and the payee may treat the amount of the end-of-line remuneration as reduced (but not below nil) by any one or more of the following:

- the amount of the deemed payment;
- the amount of any capital allowances in respect of expenditure incurred by the paying intermediary that could have been deducted from employment income under s262 CAA 2001 if the payee had been employed by the public authority and had incurred the expenditure; and
- the amount of any contributions made, in the same tax year as the end-of-line payment, for the benefit of the payee by the paying intermediary to a registered pension scheme that, if made by an employer for the benefit of an employee, would not be chargeable to income tax as income of the employee. This does not does not apply to excess contributions paid and later repaid, contributions set against another payment by the paying intermediary or contributions deductible at Step 5 s54(1) ITEPA 2003 in calculating the amount of a deemed payment under the normal IR35 rules.

The 'underlying chain payment' means the chain payment whose amount is used at Step 1 of s61Q(1) ITEPA 2003 as the starting point for calculating the amount of the deemed payment.

Example continued

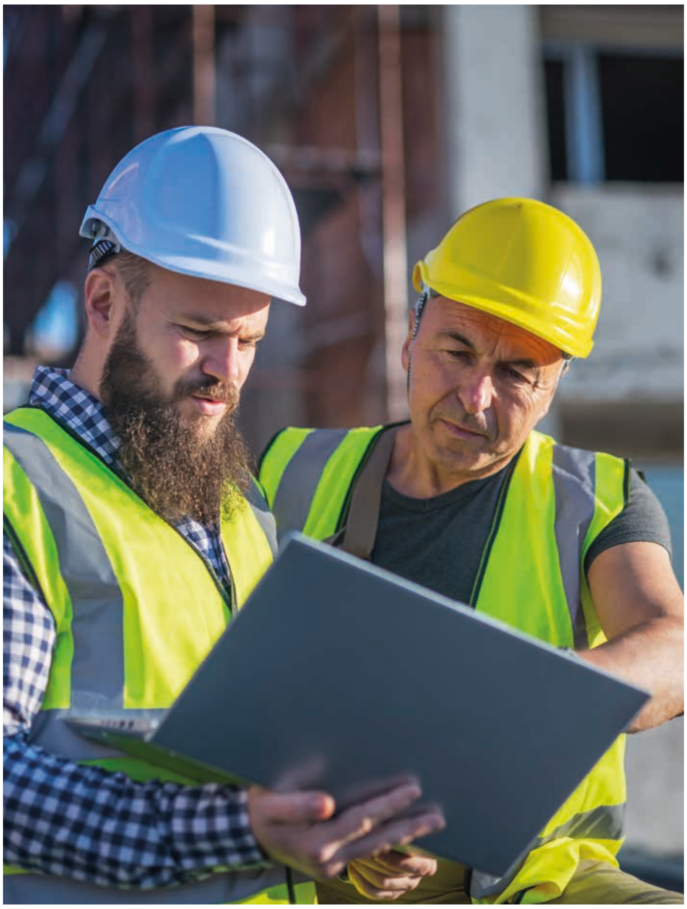
Importantly, the above rules apply whether **the end-of-line remuneration is earnings of the payee, a distribution of the paying intermediary or takes some other form**.

Bear in mind that these rules state that the paying intermediary and the payee can treat the end-of-line remuneration as reduced by the amount of the deemed payment.

Therefore, there is no double tax charge on Mark if money is taken as salary or dividend as long as the cash taken (£65,000) from the company does not exceed the amount of the deemed payment (£70,000).

In addition, Mark Ltd can reduce a salary of £65,000 by the deemed payment of salary of £70,000, so there is no need to operate a PAYE scheme in this specific example.

Alternatively, if the cash is taken as a dividend, Mark Ltd may use the following rules.



Trade deduction

Where the person is the intermediary, a deemed direct payment is treated as made and the person receives a payment which can reasonably be taken to be in respect of the same services as those in respect of which the underlying chain payment is made, the deemed direct payment is not required to be brought into account in calculating the profits of the trade.

Example continued

This seems to give Mark Ltd a corporation tax deduction for the £65,000 dividend.