HM Revenue
& Customs

Further information on the reform of the off-payroll working rules

1. Contractor Numbers

You told us that HMRC estimate that the off-payroll working rules will affect around 180,000 contractors in the private sector and there are a further 60,000 contractors who are not affected because they are genuinely outside the new rules

a) Please clarify on what information, from what source, the estimate is based?

HMRC published a Tax Information and Impact Note (TIIN) on 3 March 2021, which set out the latest estimated impacts of the reform. This estimated that the number of personal service companies (PSCs) impacted would be approximately 180,000, and that in total there would be admin burden savings for around 240,000 PSCs. The difference between these two numbers is an estimated 60,000 PSCs who, pre-reform, would have needed to consider the OPW rules, but fall outside them. Following the 2021 reform, the engagers or end clients of these estimated 60,000 PSCs need to engage with the new off payroll working rules and conclude that the engagements fall outside the OPW rules.

To establish these estimates, HMRC began with data on companies from the year ended 5 April 2019 (the latest available data when these estimates were made).

HMRC profiled for companies that had the characteristics of PSCs (this is not a defined term in legislation or HMRC systems) based on indicators such as assets, turnover and the number of directors and employees based on Corporation Tax and Companies House data.

This set of companies was further narrowed down in order to estimate the number of these PSCs who would be affected by the extension of the off-payroll working rules. Estimates were made using the Office of National Statistics Labour Force Survey, data about the companies (such as turnover/profit ratio) and other sources to establish an estimate of the number of PSCs who were engaged by medium or large clients in the private or voluntary sectors and who provided work to those clients in a manner akin to an employee. Population estimates were adjusted to reflect the time gap between the data point and the commencement of the reform. This resulted in the estimated 180,000 PSCs impacted by the reform.

To reach an estimate of the number of PSCs who would need to consider whether they fall within the rules, but in practice would fall outside them, we assumed a ratio of 3:1 in respect of the number of impacted PSCs to those needing to consider the reforms. This estimate was arrived at in conjunction with HMRC officials familiar with work on employment status and intermediaries in the labour market.

b) Please also confirm that when you refer to contractors, you mean Personal Service Companies (PSCs). For the reasons you gave these numbers should equate to the same number of individual contractors.

A typical PSC provides the services of one individual worker, so it is reasonable to assume that the number of PSCs and individual workers will be broadly similar.

2. CEST

a) Are you able to provide information on which uses of the tool relate to off-payroll working, whether they are engagers or contractors?

Please find below two tables that set out the uses of CEST, firstly broken down to illustrate the number of uses to determine the status of a direct engagement or an off-payroll working engagement, and secondly breaking down the outcomes for those using CEST for off-payroll working engagements. In the case of a direct engagement, the tool is being asked to determine the status of an individual directly engaged by the hirer. In these circumstances CEST will determine whether the individual is an employee for tax in respect of the engagement or the individual is self-employed for tax. In the case of an off-payroll working engagement, the tool is being asked to determine the status of an arrangement between the engager, the intermediary and the individual; the outcomes of the tool in that case are that either the arrangement is impacted by the off-payroll rules or not.

As the data shows, 49% of "Off-payroll working/Worker Using an Intermediary" have resulted in an "Outside" determination, with an average 66% of uses being by "Hirers".

Please note that the number of uses does not equal the number of users of the tool, as a worker or hirer may use the tool multiple times and for determining different engagements. HMRC does not ask for the identity of users of the tool.

	Total uses (Nov 2019 – Aug 2021)
Direct Engagement/ Worker not Using an Intermediary	712,080
Off-payroll working/Worker Using an Intermediary	1,125,408
Total	**1,837,488**

Breakdown - Off-payroll working/Worker Using an Intermediary (Nov 2019 – Aug 2021)	
CEST outcome	**Usage**
Outside off-payroll working rules (IR35)	Hirer – 348,553 (62%) Worker – 209,793 (38%) **Total – 558,346 (49%)**
Inside off-payroll working rules (IR35)	Hirer – 216,655 (65%) Worker – 116,776 (35%) **Total – 333,431 (30%)**
Undetermined	Hirer – 162,942 (70%) Worker – 70,689 (30%) **Total – 233,631 (21%)**
Total uses for Off-payroll engagements	**1,125,408 (100%)**

3. Umbrella Companies

a) Are you able to tell us how many contractors currently use umbrella companies or give us any indication of how many have moved into umbrella companies since 6 April 2021? We have found it difficult to reconcile the information about contractor numbers, uses of CEST and numbers using umbrella companies.

As set out in the Call for Evidence published on 30 November 2021 on the umbrella company market, external commentators have estimated that the number of employees working through umbrella companies increased from between 300,000 and 400,000 in 2015, to over 600,000 by 2021.

Evidence available to HMRC supports this perception of a market growing over time.

In 2008 HMRC estimated that the number of individuals working through umbrella companies in the 2007-08 tax year was around 100,000. In 2014 evidence available to HMRC suggested that around fifty of the larger umbrella companies alone employed 150,000 individuals during the 2013-14 tax year. HMRC analysis suggests that at least 500,000 individuals were employed by an umbrella company at some point in the 2020-21 tax year.

To supplement HMRC's analysis of internal data and the independent, external research into the effects of the 2021 off-payroll reform, the recently launched Call for Evidence will provide an up to date understanding of who works through umbrella companies and how they are engaged.

There is not necessarily a direct link between the number of contractors impacted by the 2021 reforms and the number of uses of CEST in any given period, nor would we necessarily expect CEST uses to directly correlate to the number of employees of umbrella companies. CEST is not mandatory for use by contractors or their engagers. CEST may be used more than once in respect of any given engagement or in respect of engagements that are being considered, but are never entered into. Clients and agencies who choose to engage workers through umbrella companies may or may not use CEST (or may use CEST multiple times) before deciding on the appropriate legal and commercial structure for that engagement.

4. Status Determination

Please would you clarify the position in the following situations:

a) where a status determination by an engager that a contractor is outside the off-payroll rules is subsequently challenged by HMRC and ruled to have been wrong?

If an engager determines that the contractor is outside the off-payroll working rules, the earnings of the contractor are treated as if they are income of the personal service company for tax purposes. The payment for the contractor's services is paid down the labour supply chain to the contractor's personal service company (PSC) without any deductions for tax or National Insurance contributions (NICs).

Where this determination is later found to be incorrect, and the contractor should have been taxed as an employee, there will be a liability for income tax and NICs that should have been deducted under Pay As You Earn (PAYE) at the time of the original payment. Who is liable for the unpaid tax will depend on a number of factors. These include:

1) whether the engager provided a Status Determination Statement (SDS) alongside their original determination. If no SDS has been provided to the party they contract with, then the engager will be liable for the tax and NICs.

2) if an SDS was provided, the second factor is whether the engager took reasonable care in making their determination. If reasonable care was not taken, then the engager will be liable for the tax and NICs. If reasonable care was taken, then the liability would pass to the lowest party in the chain in possession of the SDS (usually this is the fee-payer, being the party immediately above the contractor's intermediary in the labour supply chain).

b) where the engager determines status as employment, but the contractor self-assesses as outside the off-payroll rules (and this is upheld).

Where the engager determines that the contractor is inside the off-payroll working rules, and treats them like an employee for tax purposes, PAYE must be operated on the payments for the contractor's services. If the contractor disagrees with this determination, HMRC would expect them to use the client-led disagreement process introduced as part of the latest reforms to raise this with their engager. The engager is required to consider any representations and review their status determination. The engager must respond to the contractor within 45 days of receiving the representations, stating whether they are upholding or changing their determination.

If the contractor still disagrees with their status determination following this process, they may follow the existing income tax self-assessment and NICs refund processes to challenge their status in respect of that particular engagement and seek a repayment of the amounts deducted from their payment.

If the contractor follows these processes, they will receive a repayment of income tax and employee NICs contributions. This may later be subject to HMRC compliance checks as to the accuracy of the repayment claim. In some circumstances, HMRC will undertake checks before repayment is issued. Where a repayment of employee NICs is made, the deemed employer will receive a repayment of the employer NICs contributions paid in relation to the engagement.

Where a contractor decides to follow this route to dispute their engager's status determination, they should ensure to take reasonable care in establishing their view and completing their tax return or refund claim. Corporation tax will, in most cases, also need to be paid on earnings that are determined to be outside the off payroll working rules.

5. NICs

a) Please let us have examples showing the engager's responsibility for PAYE and the liability of the contractor/PSC, (income tax and corporation tax) and NICs (employee and employer) chargeable on each of the parties and what account is taken of tax and NICs already paid where a contractor has been wrongly determined as being (i) outside the off-payroll rules and (ii) within the off-payroll rules.

As set out in the answer to question 4a above, where the engager has determined the contractor to be outside the rules, the engager will not make deductions under PAYE on payments to the contractor. Instead, the contractor's PSC would be subject to corporation tax on the payments. The PSC will be responsible for operating PAYE on any salary paid to the contractor and the contractor will be subject to income tax on any dividends received from the PSC.

As a basic example, the supply chain will have an engager (the Client), a PSC and a Contractor. The Client determines that the Contractor is outside the off-payroll working rules and agrees to pay them a gross fee of £50,000. The contractor's PSC will usually/tend to pay the Contractor through a salary of £9,568 (the Primary Threshold for Class 1 NICs for the 2021/22 tax year) and the rest as a dividend. The Contractor will pay income tax on any dividend income. The PSC will pay corporation tax on its business profits, as well as a small amount of employer NICs. In this basic example, it is assumed that the PSC has no other deductible expenses.

Summary of liabilities (outside the rules)

The Client has no tax or NICs liabilities in relation to the payment.

PSC:

Employer NICs on contractor's salary	£ 100
Corporation Tax on profits	£ 7,663
Total liability	**£ 7,763**

Contractor:

Income Tax on dividends	£ 2,075
Total liability	**£ 2,075**

However, if the determination is later found to be incorrect and the Worker should have been inside the rules, the Client should have operated PAYE on the gross fee of £50,000. As such, the Client will become liable for unpaid amounts under PAYE, and the tax and NICs previously payable by the PSC and the contractor will no longer be due.

Summary of liabilities (later found to be inside the rules)

Client - amounts due under PAYE:

Employer NICs	£ 5,680
Employee NICs	£ 4,852
Income Tax	£ 7,486[1]
Total liability	**£ 18,018**

The PSC has no liabilities as the income has already been subject to tax. The Contractor also has no further liabilities.

As is the case for any taxpayer, where the PSC and/or contractor have paid an amount of tax or NICs that is no longer due, they will be entitled to claim a repayment.

Where a contractor has been incorrectly determined as inside the rules, the converse situation will occur. The Client will be entitled to a refund of the employer NICs that is no longer due. The PSC will be liable to Corporation Tax on the payment as business income. The Contractor will be entitled to a repayment of the employee NICs no longer due, as well as a repayment of any overpayments of income tax.

[1] For simplicity, this is calculated on the basis that this is the contractor's only engagement in the tax year and that they have no other sources of income that would have utilised their personal allowance.