Hebblethwaites

Chartered Accountants & Registered Auditors

ICAEW CHARTERED ACCOUNTANTS

KEY GUIDE

Off-payroll working

Introduction

THREE DIFFERENT TAX TREATMENTS

If you work as a contractor, there are three different possible tax treatments which could apply to your engagements depending on your circumstances.

- For contracts not subject to the off-payroll working (IR35) rules, whether working in the private or public sector, you will be in a position to withdraw profits on a very advantageous tax basis.
- If working for a medium or large private sector client, or in the public sector, and the off-payroll working rules apply, then you will effectively be treated as an employee, despite the use of your intermediary company.
- If working for a small private sector client and a contract is caught under the off-payroll working rules, that income will be paid gross to your company, but will then be subject to PAYE. This means much of the tax advantage of not being subject to the off-payroll working rules is lost, although the tax treatment is not quite as onerous as being treated as an employee.

Neither the October 2024 Budget nor the March 2025 Spring Statement made any mention of the off-payroll working rules, so, unfortunately, contractors will have to plan for their continuance for the foreseeable future. The increase to the rate of employer national insurance contributions (NICs) to 15% from 6 April 2025 (it was previously 13.8%) means there is additional cost where a contract is caught under the off-payroll working rules. Additional employer NICs are also payable because the starting point has dropped from £9,100 to £5,000.

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This publication is for general information and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. This publication represents our understanding of law and HM Revenue & Customs practice as at 5 April 2025.

What is meant by off-payroll working?

If you work on terms that amount to employment, your employer must deduct income tax and NICs from your pay under PAYE. You can only be paid gross if you are genuinely self-employed. Prior to the introduction of the off-payroll working rules, someone could circumvent these tax requirements by setting up an intermediary company that would contract with the client to provide services.

The off-payroll working rules prevent you from saving income tax and NICs by interposing a limited company between you and your client. The rules – known as the 'IR35 rules' after the number of the press release in which they were first announced – only take effect where you would be treated as an employee if you worked directly for the client under the same terms.

Company qualifying conditions
The off-payroll working rules are targeted at one-person companies. The rules therefore only apply if your company meets certain conditions:

- You or your family controls more than 5% of the company's ordinary share capital.
- You or your family is entitled to receive more than 5% of any dividends paid by the company.

For these conditions, 'family' includes an unmarried partner.

TAX ADVANTAGES IF NOT SUBJECT TO THE OFF-PAYROLL WORKING RULES

Payments made to your company by the client will be made gross. You can then withdraw the profits from your company mainly by way of dividends, which are not subject to NICs. Even though the tax cost of withdrawing profits by way of dividends has substantially increased in recent years, this approach can still be beneficial when compared to being taxed as an employee.

However, the tax increases have removed much of the tax advantage of operating via a company, with the higher corporation tax rates which now apply for companies with annual profits in excess of £50,000 further eroding the advantage. The government has said that the higher rates of corporation tax will remain in place for the foreseeable future.

Other tax savings are possible because:

- Companies can deduct more expenses than employees.
- Higher rates of income tax can be avoided by retaining profits within the company.
- Dividends can be shared with a spouse.

SMALL, MEDIUM OR LARGE SIZED?

For company clients, size classification is based on the Companies Act definition. Therefore, a client is considered medium or large if they meet at least two of the following three conditions:

- an annual turnover of more than £15 million;
- a balance sheet total of more than £7.5 million; or
- more than 50 employees.

For non-corporate clients, a simplified test is used. They are treated as medium or large if annual turnover is more than £15 million.

Clients who do not meet these conditions are considered small for the purposes of the off-payroll working rules.

An overseas client without any UK presence is treated the same as a small client.

Public sector definition
As far as the public sector goes, this covers government departments, legislative bodies, the armed forces, local government, the NHS, schools and further and higher education institutions, the police, other public bodies and publicly owned companies.

DETERMINATION OF STATUS

If working for a small private sector client, then you are responsible for determining your own status and whether you are inside or outside of the off-payroll working rules.

If working for a medium or large private sector client, or in the public sector, then responsibility for deciding whether the off-payroll working rules apply lies with the client.

Status will have to be re-checked if the working practices of the engagement change or a new contract is negotiated.

HMRC charges a penalty for any inaccuracy relating to the operation of the off-payroll working rules.

CEST tool
Regardless of who has responsibility, the off-payroll working status of an existing or future engagement can be checked using the check employment status for tax service (CEST) tool provided by HM Revenue & Customs (HMRC). HMRC will stand by the result provided the information submitted is accurate.

The CEST tool has been criticised for providing inaccurate results, and is widely reported to be difficult to use. Not surprising given that the CEST tool is quite often unable to establish a contractor's employment status.

The extent of the difficulty in determining status can be seen by the problems encountered by various government departments who have found themselves liable for millions in additional tax after erroneously relying on the CEST tool.

You might also find HMRC's Employment Status Manual (ESM 4100) useful, as it includes examples from various professions.

Status communication
When a medium or large private sector client determines off-payroll working status for a contract, they must provide a status determination statement (SDS) confirming the conclusion and the reasoning behind it. The SDS must be provided regardless of the outcome of the status determination.

The SDS must be passed to you, as the worker, and also to any other party the client has contracted with, such as an agency.

Planning point

You can dispute the determination given to you if you disagree with it, and have until the final payment is made for your services to do so. You must provide your reasons for disagreeing. The client must respond within 45 days from the date they receive your disagreement, and during this time the off-payroll working rules will continue to be applied in line with the original determination.

FACTORS AFFECTING YOUR STATUS

The off-payroll working rules are applied on a per contract basis, so for each contract (or engagement) the client or yourself (depending on who is responsible for status determination) must decide if you are effectively working on an employed or on a self-employed basis – the off-payroll working rules will not apply if you are working on a self-employed basis.

To get an idea of the likely outcome, ask yourself the following questions:

- Do you have to do the work yourself, or can you hire someone to do the work for you or engage helpers at your own expense? The requirement for you to provide a suitably qualified or skilled substitute in your absence is a strong indicator of self-employment, but less so if the client has the right to reject your substitute, if substitution does not actually take place or if the substitute is paid by the client.
- Can the client tell you, at any time, what to do, when to work or how to do the work? This would be an indicator of employment.
- Do you work a set number of hours, or a given number of hours each week or month? This indicates employment.
- Do you work at the client's premises? This indicates employment.
- Are you paid by the hour, week, or month (indicating employment) or have you agreed to work for a fixed price regardless of how long the contract takes (indicating self-employment)?
- Do you generally work for one client at a time, rather than having multiple simultaneous contracts? Having many different clients is a good indicator of self-employment.
- Can you make a loss on the contract? For example, you might quote a fixed contract price, and therefore take a risk that the job overruns or that you have to correct unsatisfactory work in your own time and at your own expense. This is a strong indicator of self-employment.
- Do you provide the main items of equipment for you to do the job – not just the small tools that many employees provide for themselves? If, for example, you work exclusively from home and use your own computer equipment, this is an indicator of self-employment.

Planning point

If you are uncertain about a client's size, you can request confirmation of size, with clients legally obliged to respond to such a request within 45 days.

TREATMENT AS AN EMPLOYEE

You will effectively be treated as an employee if caught under the off-payroll working rules and you are:

- working for a medium or large private sector client; or
- working in the public sector.

Although the client is responsible for determining your employment status, it is the fee-payer who will have to deduct income tax and employee NICs and pay this over to HMRC. Details are reported to HMRC under the real time reporting requirements. The fee-payer has to pay employer NICs to HMRC, but is not allowed to deduct this amount from the payment made to your company.

The fee-payer is the organisation that pays your company, and will often be different to the client.

If there is a labour supply chain involved, the SDS must be passed down each stage of the chain until it reaches the fee-payer. If the client doesn't pass the SDS down the supply chain, then the client is treated as the fee-payer until such time as the SDS is passed on.

The client can also end up being treated as the fee-payer where there is:

- failure to take reasonable care when making a determination; or
- failure to respond within 45 days to a disagreement regarding a determination.

Tax treatment in your company
Payments made to your company by the fee-payer will be net of income tax and employee NICs.

The amount received, net of income tax and employee NICs, can then be withdrawn without any further tax implications. This avoids a double charge to tax. You can withdraw this income by paying yourself:

- a salary through your payroll (without accounting for income tax or NICs); or
- dividends (these do not need to be shown on your tax return).

Lack of employment rights
Even though you are taxed as an employee, you will not become entitled to the rights and benefits that go with employment, such as holiday pay, statutory payments and pension auto-enrolment. This is made quite clear in HMRC guidance to fee-payers.

INCOME IS PAID GROSS TO YOUR COMPANY

Your company will be paid gross when working for a small private sector client (or an overseas client without any UK presence) and you determine your contract to be within the off-payroll working rules.

There are no off-payroll working implications where income is then withdrawn as remuneration, but the rules prevent any tax saving either through paying dividends or by leaving money in the company. This is done by imposing income tax and employer/employee NICs on all the income your company receives in respect of contracts caught under the off-payroll working rules, subject to certain deductions. The deductions are:

- Your actual gross salary, any taxable benefits, plus the related employer NICs (the salary and benefits having already been subject to income tax and NICs). Only employer NICs actually paid are taken into account, so the annual allowance of £10,500 will be deducted from the employer NICs, should this be available (it is not available if you, as a director, are the company's sole employee).

Credit: iStock/Jacob Ammentorp Lund

- The company's contributions to an approved pension scheme.
- A flat rate expense allowance (calculated as 5% of income) to cover administrative costs. This expense allowance is not available where the off-payroll working rules treat you as an employee.
- Direct costs such as computer costs, subsistence, training and payments to sub-contractors. Although you can claim for business travel, any deduction is likely to be somewhat limited given that business travel does not include home-to-client travel and subsistence.

The balance of the off-payroll working income remaining after the permitted deductions is deemed to be your salary.

Detail	Deadline
Deemed salary.	Treated as paid on 5 April – the end of the tax year.
Submitting details to HMRC under the real-time reporting requirements.	5 April – the end of the tax year.
Payment of the company's employer NICs, your employee NICs and the income tax on the deemed salary to HMRC.	22 April following the tax year (19 April if you do not pay electronically).

The £10,500 employment allowance cannot be claimed in respect of employer NICs payable on a deemed salary.

You have to make the calculation based on the tax year, regardless of your company's accounting date. The gross amount of deemed salary is treated as your employment income for all tax purposes. This means you must include it on your tax return, which might result in other income being taxed at higher rates than would otherwise be the case.

Your company's tax position

Your company will pay corporation tax on its profits in the usual way – with one difference. In calculating taxable profits, the company can deduct the deemed salary and associated employer NICs. The deduction is made in the accounting period in which the deemed payment date falls.

Planning point

Make sure that your company records are up to date, because the reporting and tax payment requirements permit very little leeway.

The deemed salary can subsequently be withdrawn as a dividend without any further tax consequences. This is because a claim can be made to reduce the dividend by the amount of the deemed salary – effectively making the dividend exempt from tax. Alternatively, the deemed salary could simply be retained in your company without any further tax implications.

WHEN THE OFF-PAYROLL WORKING RULES APPLY

Employee treatment has applied to public sector engagements since 6 April 2017, and to medium and large private sector client engagements since 6 April 2021. In both cases, the change of tax treatment has been extremely unpopular.

When the public sector change took place, many contractors decided to stop working in this sector, but such an approach is not realistic with the latest expansion of the employee treatment.

Employment

Many clients avoid the off-payroll working rules by simply taking contractors on as employees, either on a short-term contract or on a permanent basis.

If your contract would have been caught within the off-payroll working rules anyway, such a move may be the best option. You will save the costs of running your own company, and will be entitled to employment rights, including:

- holiday pay;
- pension auto-enrolment;
- statutory sick pay;
- statutory maternity/paternity/shared parental/adoption/bereavement/neonatal care leave;
- minimum notice periods and protection against unfair dismissal; and
- statutory redundancy pay.

However, employment may not appeal for contractors who do not want to lose flexibility in their working arrangements. Also, disincorporating your company may not be straightforward.

Umbrella companies

If all of your engagements are caught under the off-payroll working rules, you may decide there is little point in retaining your company given the ongoing costs involved. One option is joining what is known as an umbrella company. There will be no change to your tax treatment, but the umbrella company takes care of all of the administration and offers full employment rights.

However, you need to check that the fees charged by the umbrella company are not going to be substantially more than the cost of you retaining your own company – although even if this is the case, many clients may insist that you use an umbrella company.

From April 2026, the legal responsibility for deducting income tax and NICs will be moved from the umbrella company to

the client (or employment agency). The aim is to clamp down on tax avoidance, but it will invariably make the use of an umbrella company less attractive .

Planning point

Be careful in picking an umbrella company because some are more reputable than others. One warning sign is if the umbrella company advertises that you will be reimbursed using a loan without any income tax or NICs deducted – this is tax avoidance. The government has introduced a package of measures aimed at protecting contractors from non-compliant umbrella companies.

TAX PLANNING AND PITFALLS

When the public sector rules changed in 2017, there were rumours of public bodies taking a blanket approach and deeming all contractors working via an intermediary company to be within the off-payroll working rules. Although this initially happened to some extent with private sector company engagements, there is a growing move back towards the use of contractors who are operating outside of the off-payroll working rules. This is being achieved by clients carefully packaging parts of a contract into specific project deliverables.

The employment contract

Planning generally means having an off-payroll working friendly contract that establishes a self-employed relationship. However, your actual day-to-day working practices must match those stated in the contract, e.g. there is little point having a substitution clause if it is never made use of.

Under no circumstances should the contract mention you personally by name – the contract must be solely with your company. The contract will not be off-payroll working friendly if it prohibits you from taking on other work at the same time.

Signs of employment

Be careful of your client asking you to stop working on your current assignment and to start working on something else. This suggests client control and is a strong indicator of employment.

Similarly, be wary of completing any tasks requested by the client that are not covered in the contract. Also, be careful when it comes to being named on the client's organisation chart, having a client email address or network privileges, and having the client's business cards.

Taking time off for holidays and sick leave should be managed carefully, so that it does not seem as if you are asking the client's permission. And, although it might be tempting, the client should not be paying for your training, nor should you be eating in the client's staff canteen.

Planning point

If you are working through an employment agency, you must make sure that any contract between the agency and the client is the same as the contract between your company and the agency.

OTHER AFFECTED PARTIES

The scope of the off-payroll working rules is quite wide.

- If the client is based overseas, the client is still responsible for applying the off-payroll working rules if they have a permanent establishment in the UK. If no permanent establishment, the contractor is responsible for their own status.
- Although this guide deals with companies, the off-payroll working rules can also apply to partnerships used as an intermediary between a business and the client.

HOW WE CAN HELP

We can help you to decide whether your engagement falls within the off-payroll working rules, or help you to ensure that it does not.

If you receive gross payments, we can calculate the tax and NICs you might have to pay on any deemed salary, help you to pay these on time and complete all necessary tax forms. We can also steer you through the more complex areas such as overseas issues.

Our aim is to relieve you of all your tax worries so that you can concentrate on doing your job.

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