

Demibourne update

Historic position

Historically, where HM Revenue & Customs (HMRC) have successfully argued that an individual who has been engaged on a self-employed basis is in reality an employee, HMRC generally sought to recover only the employer's NIC in cases where they were satisfied that the individual had paid tax and NIC as self-employed, such as individual subcontractors.

However, following the case of *Demibourne Ltd v HMRC* (Demibourne), heard before the Special Commissioners, HMRC changed their approach in these circumstances, in that HMRC would now seek recovery of the full amount of PAYE and NIC from the deemed employer without taking into account any income tax and NIC paid by the worker via self-assessment.

Current position

Clearly, the change in HMRC's approach has caused difficulties for both the employer and HMRC as in many cases this new approach led to double taxation. HMRC, whilst looking for a long-term solution, introduced a procedure which helped, to a degree, to smooth the process. Under this procedure, the individual would need to complete and sign what became known as a Demibourne mandate. By completing and signing a Demibourne mandate, the individual claims a refund of income tax paid under self-assessment on the basis that it has been paid in error and authorises HMRC to use the repayment to set against the PAYE now payable by the employer (HMRC says that the right to set off the NIC already exists without a mandate).

Developments

Having recognised the difficulties the Demibourne issue was causing, HMRC set up a working party of industry representatives and professional organisations, including Grant Thornton.

The purpose of the working party was to discuss the difficulties being caused with a view to finding a workable solution. HMRC have recently announced that new legislation will be laid before Parliament to redress the problem.

HMRC authorised members of the working party to release a statement on what has been agreed to date. Both the Chartered Institute of Taxation and the Institute of Chartered Accountants in England and Wales have put an announcement providing details of the agreement on their website (the text of which is replicated below). It was hoped that the draft legislation would have been introduced as part of the Budget (as a gesture of good will rather than as a legal necessity) but alas this was not to be. We at Grant Thornton, however, are hopeful that a formal announcement by HMRC will be made in the not too distant future. In the meantime, if this is an issue which is relevant to you and you would like assistance please contact the Grant Thornton helpline or Anil Patel on 020 7728 3366.

Chartered Institute of Taxation statement

Proposed amendments to PAYE legislation following Demibourne

Issuing Department

HM Revenue and Customs

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Abstract

HMRC is proposing to amend the PAYE Regulations with effect from 6 April 2008, to extend the limited circumstances in which it can make a direction to transfer a PAYE liability from an employer to an employee, following the Special Commissioner's decision in the *Demibourne* case involving a recategorisation of employment status.

Full Text

Proposed new legislation to deal with the tax consequences of a change of employment status

Introduction

The Special Commissioner's decision in the case of *Demibourne Ltd v Revenue and Customs Commissioners* (SpC 486) [2005] STC (SCD) 667 highlighted a number of tax issues for employers and their employees which can arise as a consequence of a recategorisation of employment status. These issues relate to a situation where income tax and National Insurance contributions (NICs) have been paid in relation to the recategorised income, but by the wrong legal person.

The *Demibourne* case confirmed that where an employment relationship exists, the employer is responsible for deducting tax from payments made to the employee in accordance with the PAYE Regulations and HMRC does not have the discretion to choose whether to collect tax from the employer or the employee. This can lead to a situation where HMRC are obliged to seek recovery of PAYE tax and NICs in relation to income from the employer on which tax has previously been paid by (or on behalf of) the employee under Self Assessment.

Over recent months HMRC has engaged with the main bodies of the tax and accountancy profession and business to identify a solution to the issues highlighted in the *Demibourne* case. As a consequence of this dialogue a legislative solution is being proposed. HMRC is now discussing this with a wider group of key stakeholders representing the tax and accountancy professions, employer groups and individuals.

Proposed legislative changes

The proposed solution will require an amendment to the PAYE Regulations to extend the limited circumstances in which HMRC can make a direction to transfer a PAYE liability from an employer to an employee. This new authority to make such a direction will apply where -

- a) the employee has received relevant payments (including notional payments) in relation to which the employer is required to deduct or account for tax in accordance with the PAYE Regulations.
- b) the amount of tax which the employer was required to deduct or account for in

accordance with the PAYE Regulations in relation to the relevant payments exceeds the amount of tax actually deducted or accounted for, and

- c) HMRC considers that a liability to tax has been assessed on the income in question a self assessment made on or behalf of the employee; or where a self assessment has not yet been made but HMRC consider that income tax has been paid in relation to the income in question as a self assessment payment on account or as a sub-contractor deduction.

It is proposed that the following rules will apply in relation to any direction made under the new authority -

- The amount specified in a direction issued to the employee will be restricted to the amount of income tax that HMRC considers has been assessed or paid by (or on behalf of) the employee under (c) above.
- The amount of tax determined by HMRC under regulation 80 of the PAYE Regulations as unpaid tax payable by the employer will not include any tax specified in a direction for the year in question.
- The employee's entitlement to a 'PAYE credit' under regulation 185 of the PAYE Regulations for tax not deducted/accounted for by the employer will be exclusive of any amount specified in a direction for the year(s) in question.

In practice this will produce the following outcomes for the worker and employer respectively -

- **(for the employee)** the employee's self assessment for the year(s) in question will remain undisturbed. The tax already assessed in accordance with the self assessment will equal the transferred PAYE liability leaving the employee with no additional and unexpected liability. Where a direction is made in relation to tax paid as a payment on account of tax payable under self assessment, the employee's entitlement to include a PAYE credit in the self assessment for that year will be reduced by the amount of tax specified in the direction.
- **(for the employer)** the employer will be relieved of PAYE liability otherwise due under the PAYE Regulations to the extent of the amount (or combined amounts) of tax specified in a direction to an employee(s) for the year(s) in question. However, the employer will remain liable for any PAYE tax in excess of the amount(s) directed to employees along with interest and any penalties.

National Insurance contributions

There are no corresponding amendments required to the National Insurance contributions Regulations as HMRC already has legal authority to off-set wrongly paid Class 2 and 4 contributions against Class 1 (employee) contributions properly payable.

Implementation timetable

HMRC are currently developing amended regulations to give effect to the proposed solution with a view to making and laying a Statutory Instrument to come into force on 6 April 2008.

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