Think Ahead ACCA

# Technical factsheet: accounting and tax treatment of IR 35 deductions

# in the public sector

### Recap of the new rules

From April 2017, where a public sector organisation engages an off-payroll worker through their own limited company (personal service company or PSC), that organisation (or the recruitment agency through which the worker is engaged) will become responsible for determining whether the rules should apply, and, if so, for paying the right tax and national insurance contributions (NICs).

The public sector engager or agency is treated as an employer for the purposes of taxes and class 1 NICs, and so the amount paid to the worker's intermediary for the worker's services is deemed to be a payment of employment income or of earnings for class 1 NICs for that worker.

The public sector engager or the agency is liable for secondary class 1 NICs and must deduct tax and NICs from the payments they make to the intermediary in respect of the services of the worker. So the PSC will only ever receive net income.

The person deemed to be the employer for tax purposes is obliged to remit payments to HMRC and to send HMRC information about the payments using real-time information.

### Accounting treatment of the income

ACCA's Technical Advisory helpline has had many calls querying the accounting treatment of the transactions under the new rules. There is currently very little guidance available and all the accountancy blogs show a high level of confusion and disagreement among accountants on exactly how to treat the basic double entries. The main issue is whether or not to show the income in the PSC accounts as net or gross.

The simple route would be to show the income net as many members see this as giving a true and fair view, ie that is the only income that the PSC actually receives. HMRC has issued some guidance on the taxation treatment and this appears to agree with the net income presentation; however, its advice is far from clear:

*When you are calculating your company's turnover, you should deduct the VAT-exclusive amount of the invoice, which is the amount from which income tax and NICs were deducted at source. Your company accounts should show this deduction to make sure the amount is not taxed twice.*

The other option is that income should be shown gross before any tax deductions. We consider that this will be the more appropriate treatment. This is because:

- FRS 102 gives the following definition of turnover:

The amounts derived from the provision of goods and services after

deduction of:

(a) trade discounts

(b) value added tax and

(c) any other taxes based on the amounts so derived.

We do not think that category (c) above is intended to mean taxes deducted due to the intermediaries rules.

Paragraph 8 of schedule 1, The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008, states:

*Amounts in respect of items representing assets or income may not be set off against amounts in respect of items representing liabilities or expenditure (as the case may be), or vice versa.*

FRS 102 states:

*The financial statements shall give a true and fair view of the assets, liabilities, financial position, financial performance and, when required to be presented, cash flows of an entity.*

In our opinion, financial statements that do not show the full income as invoiced would not give a true and fair view.

**Treatment**

Where the income is shown gross there will naturally be a debit in the accounting records to be accounted for (representing the tax etc deducted before receipt). Again, there are a number of possible ways of treating this debit.

We think that in order to give a true and fair view, the most appropriate treatment would be to include the debit as a profit-and-loss account item. In the vast majority of cases the most likely treatment will be to reflect this charge as part of wages and salaries costs. This is because, as highlighted below, chapter 10 part 2 allows the business to set an amount equivalent to the amount on which tax and NICs were paid at source, against the income drawn from the PSC by the worker.

The treatment may not be appropriate in the unlikely circumstances that the tax is paid but the director doesn't withdraw funds. In these cases it could be argued that the tax paid is a tax on the PSC.

Clearly, in the circumstances highlighted the director will need to consider the applicability of the continuing going concern concept.

**How does this fit in with director's remuneration/dividends?**

HMRC issued notes for agents covering the new regulations. They give an example of how remuneration could be treated:

*Amount available for the PSC to set against taxes on income drawn from the company*

Because the new chapter 10 part 2 and NICs legislation subjects the fee to the PSC to tax and NICs, the worker would feel that they are double taxed if they pay income tax and NICs on all the monies subsequently taken out of the company as dividends or employment income. Chapter 10 part 2 allows the business to set an amount

equivalent to the amount on which tax and NICs were paid at source, against the income drawn from the PSC by the worker.

Effectively:

- pay dividends, but do not put them on the client's tax returns, or
- put the money through PAYE, but do not tax it.

The following is an HMRC example where the PSC pays the worker a salary that would otherwise have attracted tax and NICs. However, the PSC is able to set against that the amount that has already been subjected to PAYE/NICs, £4,129 in our example. The PSC will incur no further PAYE/NICs liability unless the payment to the worker exceeds the level of the net fee received.

The PSC can pay the worker up to £49,548 (the deemed direct payment (DDP) net of tax/NICs) without any further deduction of tax and NICs. The PSC can retain an amount that is not greater than the sum of the net fees less salary/dividend costs without further liability to tax.

Let us suppose the PSC receives some other income, say £20,000, in that same period:

| | |
|---|---|
| Invoiced amounts (12 x £6,000 – fees + £20,000) | £92,000 |
| This should be reflected in the company as turnover | £69,548 |
| Less income (12 x £4,129 – DDP net of tax/NICS) | (£49,548) |
| Less tax and NICs deducted by fee-payer (12 x £1,871) | |
| (the PSC receives relief for employment income, tax and NIC costs) | £22,452 |
| | £20,000 |

HMRC appears to advocate showing the turnover as net of deductions and not gross. Many accountants (including ACCA members) do not agree with this approach.

**The double-entry debate and our solution**

As already noted above, there is very little guidance on the actual double entries to account for the transactions. There are various options but because of the way the new rules operate, there are inherent problems and complications as essentially company income is treated for tax purposes as salary.

The salary accounting suggestion is as follows:

Scenario: a director, working through her own PSC, invoices £18,000 + VAT for her services to a public sector organisation (PSO).

| Issue | DR £ | CR £ |
|---|---|---|
| Trade debtors | 21,600 | |
| Sales | | 18,000 |
| VAT | | 3,600 |
| | | |
| Bank (payment received) – tax/NIC deducted, for example £4,000 | 17,600 | |
| Trade debtors | | 17,600 |
| | | |
| Treatment of the £4,000 deductions | | |
| | | |
| Director's remuneration (Sales value) | 18,000 | |
| Trade debtors (deduction and tax paid at source) | | 4,000 |
| Director's loan account | | 14,000 |

## Further information

Follow this link to an article in ACCA's *In Practice* magazine on the new rules

ACCA's general guidance on public sector and IR 35 suppliers

HMRC's guidance on calculating the deemed payment

HMRC's guidance on off-payroll payments for the contractor (public sector)

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