



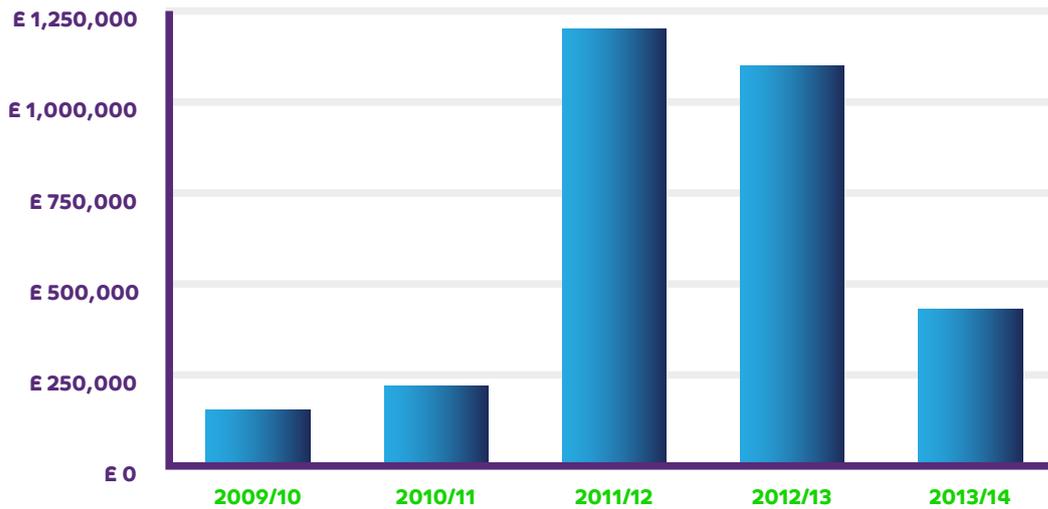
Wise up on IR35 Reform

Our concise guide provides you with a simple yet comprehensive overview of the latest updates to this important set of regulations.

Updated on 23rd February 2021

What is IR35?

IR35 is a tax law announced in 1999, which took effect from April 2000 as part of the Finance Act. Formally known as the Intermediaries Legislation, IR35 was introduced to tackle the problem of disguised employment. This is where long-term workers are engaged by organisations on a freelance basis through an intermediary (usually a limited company) rather than on a permanent contract of employment, for the primary purpose of both parties gaining a tax advantage. Although the legislation has a legitimate role to play in defending both workers' rights from unscrupulous employers and the HMRC from lost tax revenue, IR35 has been heavily criticised for its 'sledgehammer' approach.



Actual amounts raised by the Treasury as a result of IR35 investigations

2021 Reform to the Off-Payroll Rules

While the IR35 tests themselves are not changing, the way they are applied will change from April 6th.

The responsibility for determining the IR35 status of a contract will shift from the limited company contractor to the business engaging them. Importantly it will be applied to all services provided on or after this date, regardless of when the contract started.

Based on the status determination, the fee-payer (the business which directly pays the limited company - usually a recruitment agency) will be responsible for deducting the relevant tax and NICs before making payment.

These rules have already been in place for public sector organisations since 2017 and the 2021 reform will bring the two policies into line.

Medium and large private sector businesses will be responsible for determining the IR35 status of all of their contingent workers. Limited Company contractors engaged by a small business client (as defined by the Companies Act 2006) will remain responsible for making their own determinations and tax deductions.

IR35 Timeline

- April 2000 IR35 is introduced
- April 2017 Reforms to Public Sector shifts responsibility for determination from the limited company contractor to the end-client
- July 2017 Taylor Review of modern working practices highlights that separating the employment status for tax purposes from employment status could lead to the exploitation of contractors
- Widespread blanket assessments by public sector bodies leaves many of these organisations short staffed as contractors leave for private sector
- 2018 Autumn Budget announces that reforms will apply to the private sector in 2020
- Businesses introduce bans on limited companies in order to minimise risk
- 2019 Government launch Off-Payroll Review in response to widespread criticism and concludes that reforms will go ahead with a 'soft landing'
- 2020 House of Lords Review finds IR35 to be seriously flawed and recommends suspension of reform in favour of finding an alternative solution
- March 2020 Treasury confirms reforms will go ahead in March Budget, but one week later announces emergency delay until 2021 due to the Covid-19 outbreak
- May 2020 Finance Bill passes IR35 reforms as law from 6th April 2021
- November 2020, [Spending Review](#) estimates cost of 1-year IR35 delay to be £740m

How should the off-payroll rules work in practice?

IR35 reform introduces the capacity for HMRC to collect outstanding tax from other parties in the supply chain. This means that if the fee-payer fails to make deductions and pay the PAYE tax and NICs liability, HMRC can recover the unpaid debt from other organisations in the supply chain. The tax liability will initially rest with the party that failed to carry out their compliance obligations. If HMRC cannot recover the liability from them, they will attempt to collect by moving to the next party up the supply chain.

1. Client assesses status: Before the contract starts, the end-client will assess what the contractor's status will be while working on their contract. They may use HMRC's CEST tool (Check Employment Status for Tax), or engage the services of an external assessor.

2. Status determination statement is provided: Before commencing the contract, the end-client must provide the contractor with a '[Status Determination Statement](#)', which will state whether or not they believe IR35 applies as well as the reasons why. The SDS will be passed along the supply chain to the fee-payer. Until the client fulfils this obligation, they will be classed as the fee-payer and held liable for any unpaid tax.

3. Disagreement process: If a contractor or fee-payer disagrees with an IR35 decision, they can raise this directly with the end-client who will have 45 days to consider and respond, providing the reasons behind the decision. If the end-client fails to do this, they will then become the fee-payer, meaning that the IR35 liability will transfer to them.

4. Fee-payer makes necessary deductions: If you are inside IR35 the fee-payer (usually your recruitment agency) will become your 'deemed employer' and will be required to deduct the relevant tax and NICs before paying you. Some agencies/clients choose not to engage in this manner and instead require contractors to engage via an umbrella company or alternative arrangement due to payroll complications.

Problems with implementation

The Off-Payroll legislation fails to define what an employment relationship is. Instead, it uses a complex combination of ongoing case law and key status tests, none of which are determinative on their own.

Uncertainty around how to correctly apply the rules has led to many organisations to adopt **“blanket” policy** in order to avoid risk. This includes automatically classifying all contractors as inside IR35, or introducing bans on contractors working through limited companies.

Although the April 2021 reforms introduce a requirement to take “reasonable care” when making IR35 status determinations, this is not clearly defined. While blanketing is technically not permitted, role-based assessments and bans on limited companies are not ‘unlawful’ according to the legislation. This leaves contractors at a considerable disadvantage, as does the ‘client-led’ disagreement process for disputing status determinations, which is likely to be biased in the client’s favour.

A number of independent inquiries, such as the **Lords Report**, have found serious flaws within the legislation which have yet to be addressed by HMRC. In addition, the accuracy of the government’s online **Check Employment Status for Tax Tool (CEST)** has been called into question numerous times.

The Lords report also highlighted that classifying contractors as “employed for tax purposes” is unfair. If caught by IR35, the contractor is taxed as an employee. As such they will bear the burden for providing the flexibility from which both parties benefit, yet they are not entitled to any employment rights.

Don't get caught out

HMRC has specifically stated that they will not carry out targeted campaigns into previous years, unless they have reason to believe there is fraud or 'criminal activity'. However, this still leaves [HMRC with a broad scope to investigate](#). Therefore, it is advisable to have evidence of your due diligence in ascertaining your status prior to April 2021.

The criteria used to determine IR35 status can be somewhat vague. It's important that if you are utilising a limited company you give a clear indication of your employment status whenever possible. In addition to the paper contract, HMRC increasingly relies on examining the day-to-day activities of the contractor working on a specific contract. Limited company contractors should take the following basic steps to avoid misrepresenting themselves as employees:

1. Always take the time to read over your contract before signing it. Wherever possible, contracts should include a right of substitution clause stating the contractor's right to send a substitute in their place or to engage a subcontractor. Contracts should also indicate that there is no [mutuality of obligation](#) between the contractor and the end-client to provide work, such as citing a start and end date.
2. You should avoid typical employee behaviour such as using the staff canteen and accessing the building with a company security pass. In addition, you should not accept benefits such as sick pay or holiday pay from the client, while also ensuring that you're not listed on company literature. Whenever possible, you should use your own equipment.
3. Speaking to your client and agency ahead of the reform will enable you to find out what their plans are for managing the reform. This will give you some time to prepare and adjust. You should also identify, if your role is inside IR35, what is the minimum day rate you would accept when looking for assignments? Consider if you would be willing to engage via an umbrella company.
4. Review your status and maintain a record of evidence. You will still be liable for any taxes prior to 6th April 2021. It is important to ensure you continue your due diligence and maintain a record. You may need this evidence should HMRC open an enquiry into previous years or to dispute a change in your contract.

What happens if I work via my limited company and my contract is determined inside IR35?

Contracts that fall inside IR35 will be required to have PAYE and NICs deducted at source. The responsibility for making these deductions will fall to the fee-payer, which will usually be the end-client or the recruitment agency. If your contract is determined as inside IR35, your end-client/fee-payer will usually take one of the following approaches:

1. Deduct the relevant tax and NICs from your fee (net of VAT) before making payment to your limited company and absorb the cost of the Employer's NICs and Apprenticeship Levy (or pass this cost back to the client).
2. Deduct the relevant tax and NICs from your fee (net of VAT) before making payment to your limited company but adjust your rates to take into account the cost of the Employer's NICs and Apprenticeship Levy paid by the fee-payer.
3. Require you to engage via an Umbrella Company (which may be specific to their preferred suppliers).
4. Require you to engage as a permanent staff member of the client, or a temporary agency worker (employed by the fee-payer).

You will no longer be entitled to the 5% expense allowance previously provided when calculating a deemed direct payment (the payment for tax and NICs made at the end of the tax year for inside IR35 engagements).

You also cannot claim for any expenses relating to travel and subsistence when operating inside IR35. Your client/fee-payer will not be required to take into account student financing nor pension contributions when deducting taxes from your fee.

You would still deduct any employer pension contributions from your business profits, reducing your Corporation Tax bill. Where tax relief cannot be claimed at source, because tax and NICs have already been deducted by the fee-payer, you can claim this in your Self-Assessment Tax Return.

What are my options?

Your options largely depend on what course of action your end-client takes. If you mainly work on contracts that are clearly inside IR35, it's probably advisable to close your limited company and seek out the services of an umbrella company.

However, if you work on a range of contracts, you could retain your limited company for those that fall outside the scope of IR35. In some cases, companies adopting a risk averse approach to IR35 reform may revise their inside IR35 decisions. In both cases, using an umbrella company will give you the widest range of options.

As an employee of an umbrella company your IR35 risk is automatically removed. The umbrella company will deduct taxes and NICs before paying you. You will still be able to operate outside IR35 on other contracts simultaneously and easily after your current contract concludes, and utilise your limited company.

Another advantage of an umbrella company is that if you have multiple contracts with different agencies and end-clients, you will have one continuous employment. With an umbrella company, you'll also automatically receive employment-related benefits, such as holiday and sick pay.

ContractingWise have a range of flexible options that can help you to effectively manage IR35 risk while keeping your contracting career on track.

**To speak to a member of our team call:
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