

# IR35

PREPARING FOR APRIL 2021

A Robert Walters Group Company

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# What Is IR35?

IR35 is the commonly used term for the legislation introduced nearly 20 years ago to prevent “disguised employment” tax avoidance.

In simple terms, this occurs where an individual, who for all intents and purposes, would be an employee of an end user “client” but operates through an intermediary vehicle (such as a personal services company (PSC)) to avoid income taxes and to manipulate National Insurance contributions (NIC).

Avoidance arises when the disguised employee takes advantage of the lower taxation treatment of corporates compared with the higher rate for individuals.

“IR35 is relevant to the contractors who work through PSCs (or partnerships). It does not apply to umbrella workers, construction industry scheme self-employed workers or those on an agency payroll. IR35 looks at whether the contractor is working any differently from an employee of the client.”

**Richard Harris, Chief Legal Officer at Robert Walters**

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# Who is outside of IR35?

Someone who is placed “outside of IR35” must be a genuine independent contractor. If this is the case, their PSC receives gross pay, without tax or NIC deductions being applied by the client or staffing agency, as the case may be. Accordingly, the relationship between the client, the PSC and its employee who is actually performing the work, can be treated as a service supply relationship.

Employment status is not easy to define. A whole industry has grown around trying to qualify the status for independent contractors. HMRC has struggled to create a test which simply resolves the question. HMRC’s “CEST” (Check Employment Status Tool) is widely regarded as inadequate, even by its creators, not because it is inconsistent – but because it is often inconclusive.

“ The level of possible tax risk and the number of penalties for firms could be crippling. Cambridge University estimated a tax risk equal to 56% of the original cost of hiring the self-employed worker.

**Paul Sweeney, MP**



# Four key tests

There are four key tests to consider when determining IR35 status.

## **Mutuality of obligation**

Does the contractor have to accept work? Is the client obliged to provide it? If the answer is yes, then there is likely to be a mutuality of obligation. If no mutuality of obligation exists, the contractor could fall outside of IR35.

## **Substitution**

Does the role allow for the contractor to send a substitute in their place, at their own cost? For example, if the contractor is taking time off for medical reasons, can they send someone in their place? If they can't send someone else, they could be within IR35. This test is not whether a client can use someone else or whether an agency can provide an alternative.

## **Supervision and control**

The key point is that the contractor should not be dictated as to how they perform their work on a day-to-day basis. This is often tricky to overcome in professional settings.

A contractor agreement that specifies terms such as mandated working hours points towards employment (inside IR35) rather than self-employment. However, "supervision and control" does not mean that a contractor cannot be managed at all or a client cannot provide any instruction.

## **Part and parcel**

If contractors are embedded in the company structure, this is more likely to be employment rather than self-employment, and therefore likely inside IR35. For example, does the contractor have line management responsibility for the client's employees?



# What is changing?

There is a tremendous amount of press around the changes to IR35. The reality is that the underlying law will stay the same. If a contractor was genuinely outside of IR35 on 5th April 2021, they would continue to be outside of IR35 on 6th April 2021 when the law changes.

Similar rules were introduced to the public sector in 2017. At the time there was considerable criticism that those changes had not been fully consulted on and were generally rushed. Despite this criticism, HMRC hailed those changes as a success. There is a limited exclusion for very small companies.

Currently, in the private sector, PSCs are responsible for making their own assessment as to whether they fall inside or outside of IR35. If they perform the assessment incorrectly, it is the PSC, not the client or agency who is liable for unpaid tax and NICs (including employer NICs). HMRC believe that abuse of the system is widespread, but enforcement against numerous individual companies is difficult and resource intensive. The answer? Move the assessment and the liability up the supply chain to those who are much more likely to be compliant and have assets.

## Changes from 6th April 2021 to prepare for

- In March 2020, Covid-19 delayed IR35 by one year to April 2021. IR35 was passed into Primary Legislation in July 2020. It will not be delayed or altered any further. It will come into effect in April 2021.
- The client is responsible for determining whether an individual is inside or outside of IR35 i.e. if a contractor's fees must be taxed as they would be if they were an employee. The end client can use HMRC's Check Employment Status for Tax (CEST) tool, or an alternative to do so.
- Responsibility for accounting for tax and NICs will rest with the fee payer (i.e. the body responsible for paying the PSC – this may be the client where there is a direct relationship with the PSC or the agency where there is an agency in the supply chain). The fee payer will also be responsible for accounting for the employers' NICs and the apprenticeship levy.
- Liability for tax and NICs could pass to the client if they have failed to take "reasonable care" in making the decision. It is not clear as to what constitutes reasonable care. Liability could also pass up the chain if the fee payer cannot pay (e.g. it has become insolvent).
- The supply chain and the contractor must receive the determination and the decision, once it has been completed.
- The contractor has the legal right to appeal the determination outcome, and the end client must respond to the appeal within 45 days, in writing, giving reasons.
- HMRC's CEST tool has been widely criticised, not least by the House of Lords in their review. It is not the only tool, as mentioned above, that is available to use for determinations.





# Auditing your contractor population

“What is changing is the way HMRC will enforce the law, specifically who they will be enforcing against if the rules are broken.

**Richard Harris, Chief Legal Officer at Robert Walters**

One of the learnings from the public sector is that many organisations took a very simplistic approach to assessment and, in some cases, simply blanket categorised genuine independent contractors as inside IR35 and placed these contractors on PAYE contracts. This led to increased costs for those organisations but also the transition of highly skilled contractors to the private sector.

Anecdotally, many public sector organisations are now re-engaging with contractors, who qualify, on the outside of IR35 basis. Obviously, with the latest changes, contractors will not be able to switch sector to avoid what they may see as a prejudicial determination. However, over-compliance may well take place. Given that the changes will impose an appeal process, a blanket approach in the private sector could create a significant administrative burden for businesses.



# What are your options?

**Once you have completed the audit of your contractor population, you can determine the options available to you:**

## **Remain outside of IR35**

There will be a portion of the contractor population that will be outside of IR35. This option retains the status quo, and insurance products are available to mitigate the risk of an incorrect determination.

## **Pay as you earn (PAYE)**

A contractor can convert to become a PAYE engaged individual.

There is a significant risk that a contractor will terminate their assignment if this happens. Suppose a contractor is performing a role on 5th April through a PSC and has been doing so for several months. On 6th April, the client can reclassify them as a PAYE worker inside of IR35. The role would be the same, but the result of the determination would be different. This could be a potential red flag to HMRC that the contractor's "self-assessment" was wrong.

Another consideration when converting a PSC to a PAYE is that they could claim security of employment

tenure if they then have or later acquire two years of continuous service. For example, a long-term contractor who has converted over to PAYE could claim for unfair dismissal or expect to be included within redundancy consultations.

PSC contractors that are converting could also, in some cases, attempt to claim under the Agency Worker Regulations – this is not the intention of the legislation but could be an unintended consequence.

## **Deemed model**

The contractor can remain a contractor and can remain as the director of their PSC, but for this particular assignment, is "deemed" inside of IR35, and the agency then has to withhold the appropriate taxes. This is helpful when a contractor switches between assignments to which a different status will attach. Deemed is not being used in the private sector, as a general rule, as it is considered too complicated, and to carry too much risk, to be a viable alternative to PAYE or umbrella (see below).





## **Umbrella**

If determining that a lot of roles will be inside of IR35, it may be an option to offer the services of an umbrella company to contractors, as the umbrella will withhold necessary taxes, but also offer PAYE benefits to the contractors (health, pension, loyalty schemes etc). Using an umbrella contractor could also help mitigate IR35, as the contractor would be an employee of the umbrella company.

## **Statement of work (SOW) solution**

If a piece of work can genuinely be delivered through milestone and deliverable based outcomes, then SOW is a viable solution. With a SOW, the agency becomes the “end user” rather than the client. However, the agency will still face the same issues of IR35 determination if it uses contractors to fulfil its tasks.

Although on paper a SOW can appear to be a genuine service provision relationship, if the reality is that it is not genuine, and therefore the client is really the “end user” and not the agency, liability for incorrect payment of tax and employers’ NIC could fall to the client. The client will not have made any assessment because supposedly, it was not their responsibility and therefore they could not have taken reasonable care. This places the client in a worse position than if they had made the assessment with reasonable care, but simply got it wrong. It is our view that sham SOWs could be an early target for enforcement.

SOW requires more work and thought to put in place successfully – deliverables need to be properly managed, described and measured. This leads to additional cost to the client.

## **Employed consultant**

The increasingly popular Employed Consultancy model began in the graduate market before moving to mainstream contingent roles. It can be delivered through either SOW channels or the traditional contractor route (i.e., Time and Materials, or T&M). In this model, the worker is employed by a service provider, then redeployed to you as the client, generally under a T&M basis, and billed as days worked either through timesheets or under a wider SOW agreement.

This model exposes companies to less risk because the workers are employed by someone else. However, it does not mitigate all risk. It also means that you are only paying for days worked (although it relies on your required skillset being available and willing to be classed as a permanent employee).

In contrast to a true SOW agreement, it does not assume a high level of accountability or liability for the end project, and therefore has specific use cases rather than being an answer to IR35.



## Next steps

The changes to IR35 are very much about industry self-policing rather than enforcement. It is still the case that HMRC does not have significant resources to pursue large numbers of contractors they suspect of being incorrectly determined as outside of IR35, even through you. That is not to say that they will not pursue cases and indeed may look to a high-profile scalp if they believe the measures are not creating the right compliance culture.

“There may be a temptation for over-compliance by you, and this could be a problem for HMRC when contractors dispute the position through self-assessment — clogging a system which had become efficient for the most part” says Sam Walters, Legal Director at Robert Walters.

Another knock-on consideration is that some individuals work permit status could be affected if they are to become PAYE temporary employees rather than self-employed PSCs – for example those working under Tier 1 Entrepreneurial Worker Permits. The status of PSCs using these permits was always somewhat tenuous and it may well be the case that affected individuals will not be able to continue working unless sponsored as an employee of the client or the agency. Both options are unattractive and difficult to achieve, especially for short-term assignments.

“Begin forward planning as soon as possible. That includes starting to educate the market, getting compliance practices in place, and understanding how altering contractor work practices can ensure working outside of IR35 remains an option.

**Nicola Hayman, Legal Manager at Kingsbridge**



The initial recommendations from the Good Work Plan (GWP, formerly Taylor Review), went live in early April 2020. One of the key points from the GWP was to look at tenure limits, with a recommendation that 12 months may be optimal. Whilst the Government has indicated a desire to adopt all the recommendations from the GWP, tenure limits is not one of the points that came into effect in 2020.

However, if the Government were to adopt 12 months as a limit, this could further impact the use of contractors for a sustained period, i.e., an on-going project.

“ Putting the financial implications to one side, the logistical challenges for the private sector are enormous. An estimated 600,000 self-employed freelancers work in the UK, and they and their firms will be affected by the reforms.

**Paul Sweeney, MP**



# What should you do next?

It is imperative that any plans and determinations that were shelved in March 2020 be dusted off and reinvigorated. Given the unprecedented impact of Covid-19 on the economy, there will have been resource changes within organisations, and some IR35 knowledge may have been lost.

## Robert Walters recommendations

1. All original plans, processes and approaches to IR35 be reviewed, especially considering Covid-19 which may have impacted the “Control” and “Part & Parcel” aspects of your working practices.
2. Refresher training sessions on IR35 to be held.
3. Re-establish your contractor population (audit) as it will have changed since the March delay.
4. Any “pre-March” determinations completed for remaining contractor populations be re-completed and shared.
5. Any new contractor population since March 2020 needs to have a determination completed.
6. Re-familiarise yourself with the determination tool and process. If you used CEST previously, also review this and ensure it is the right tool for your organisation to use for determinations.
7. Ensure your appeals process is in place and ready to receive appeals.
8. Reinstate your communication processes, frequently asked questions and internal policies around IR35.
9. Update any of your IR35 timelines, especially with regards to pay/invoicing dates.



### What is next after the deadline passes?

From April 6th 2021, Robert Walters will only engage PAYE workers, Umbrella workers and Limited Company Contractors, on the condition that the latter are engaged for a role that is determined to be outside of IR35 by the client.

We will be working with clients from the beginning of the recruitment process to discuss their preferences and will be recruiting in line with those preferences.

# Contact us

Find out more how Robert Walters can help you prepare your business for upcoming IR35 legislation.

[contact@robertwalters.com](mailto:contact@robertwalters.com)





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