

What is IR35?

IR35 is highly complex tax legislation that came into effect in 2000, and has undergone significant iterations in the years since. It is designed to combat tax avoidance by workers who supply their services to clients via an intermediary, such as a limited company (PSC), but who would be an employee if the intermediary was not used. Such workers are called 'disguised employees' by Her Majesty's Revenue and Customs (HMRC).

In the Budget Statement in October 2018, the Government announced its intention to reform the legislation changes around Off Payroll Workers (also known as IR35) in the Private Sector – an extension to the changes implemented in the public sector in April 2017.

For clarity, 'Off Payroll Workers' simply means contingent workers (contractors and temps) – it is not something different to IR35. It applies to workers who operate through a Personal Services Company (PSC), also referred to as a Limited Company.

Why is the government introducing it to the Private Sector?

Our economy and labour markets have changed significantly over the last 30 years, with a considerable increase in self-employment. This has been a concern for the government as they suspect that people working through an intermediary, like a PSC, may not be paying the correct amount of tax. HMRC estimates the cost of non-compliance at £1.2billion per annum by 2023.

The Chancellor stated: *"following our consultation, we will now apply the same changes to private sector organisations as well. But after listening carefully to representations made during the consultation, we will delay these changes until April 2020 and we will only apply them to large and medium-sized businesses."* But, following the COVID-19 crisis, the government then delayed the introduction of this new legislation until 2021.

HMRC stated that they were introducing the changes to improve fairness in the tax system by ensuring that where individuals are working for a company via an intermediary (such as their PSC or Ltd Company) they are not able to 'sidestep employment taxes' or National Insurance Contributions (NICs).

HMRC has a limited track record of success in disputing individual cases and the cost of disputing cases was too high to maintain. They see shifting responsibility to the end user as a way to more effectively drive compliance.

The current timeline for introduction

- **5 March 2019** Consultation document issued
- **28 May 2019** Consultation ended
- **11 July 2019** Draft legislation published
- **Autumn 2019** Parliamentary/Royal Assent
- **5 April 2021** Legislation comes into effect

IR35 will then apply to all payments made to the contractor on or after that date. Therefore the legislation applies to existing contracts where work is completed prior to 5 April 2021 and the payment is made to the PSC on or after the 5 April 2021.

Which workers does IR35 affect?

It applies to Off Payroll workers. HMRC defines this as a worker who provides a service through his or her own intermediary. An intermediary can be:

- Workers own limited Company
- A partnership
- Another individual

IT DOES NOT AFFECT WORKERS ENGAGED VIA UMBRELLA OR PAYE MODELS

Which clients does IR35 affect?

It applies only to Medium and Large companies – small companies are exempt from the legislation.

A medium and large company is classified as having 2 or more of the following:

- Turnover more than £10.2m
- Balance sheet more than £5.1m
- 50 or more employees

What are the criteria for determining IR35 status?

The main criteria used in tribunals for assessing IR35 status are:

- Right to Substitute – what is the process around this? Who offers permission to substitute? Who pays the Substitute? These are all important points to consider when thinking about worker substitution.
- Supervision, direction & control (SDC) – is the worker fully responsible for the delivery of the service and, as such, takes full responsibility? A detailed schedule of services, including tasks and timelines is a must for all in the supplier change.
- Financial Risk – does the contract have financial penalties in place for late delivery or an incentive to deliver ahead of schedule? Are defects contracted to be fixed by the worker for a several years after delivery?
- ‘Part & Parcel’ of the organisation – has the worker been in situ for some time i.e. a few years? Is the worker providing services which are likened to existing permanent employees?
- Equipment – does the worker provide equipment in order to fulfil the deliverables noted within the contract?
- Mutuality of Obligation (MOO) – for an employment relationship to exist, there must be an obligation on the client to provide work to the worker and an obligation on the worker to carry out the work.

What changes can we expect from the legislation?

The draft legislation has now been issued, with the final legislation only being released later this year. The changes will mirror those introduced into the public sector in 2017, with some additional proposals expected:

- From 5 April 2021, medium and large businesses will need to decide whether the rules apply to an engagement with individuals who work through their own company.
- The responsibility for assessing the employment status for a contractor’s engagement will move from the PSC/ Limited Company, to the private sector organisation, or ‘End Hirer’ (client) who engages them. This means that the End Hirer will have to assess the employment status of all existing workers engaged through a PSC.
- If the assignment falls within IR35 (often referred to as ‘caught’ by IR35), then the “Fee Payer” (the party contracting with the PSC, i.e. an agency) is responsible for making all relevant employers and employees National Insurance and income tax deductions from the PSC’s gross pay and paying these directly to HMRC.
- The End Hirer will be liable for unpaid taxes/fines if they do not make a determination, and do not pass this to the fee payer.
- The End Hirer will be liable for unpaid taxes/fines if they have not used reasonable care in determining the status.
- The Fee Payer will be liable for unpaid taxes/fines if they do not process the payment in line with the End Hirer determination.
- There will be a requirement for the End Hirer to implement a “client led disagreement process” whereby a contractor can request a review of their status if they believe it to be incorrect.

How clients should make an assessment on Worker IR35 status

HMRC developed an online employment status tool “Check Employment Status for Tax” (CEST) to support organisations in helping them to determine whether the rules apply “in the majority of cases”. They have stated that the questions used in the tool are based on case law. Clients must test assignments using this tool.

Read the guidance at <https://www.gov.uk/guidance/check-employment-status-for-tax>

Be-IT’s responsibilities as the fee-payer

When we receive the worker’s employment status determination and the off-payroll working rules apply, we must:

- calculate the deemed direct payment to account for employment taxes and National Insurance contributions associated with the contract.
- deduct those taxes and employee National Insurance contributions from the payment to a worker’s intermediary.
- pay employer National Insurance contributions.
- report to HMRC through Real Time Information the taxes and National Insurance contributions deducted.
- apply the apprenticeship levy and make any payments necessary.

Employment allowance cannot be used against payments to deemed employees.

The new rules apply to any payments made to the worker’s intermediary on or after 5 April 2021. This is the case even if the work was done before 5 April 2021.

How Be-IT calculate deemed direct payments

The deemed direct payment is the amount paid to the worker’s intermediary that should be treated as earnings for the purposes of the off-payroll rules.

1. Work out the value of the payment to the worker’s intermediary, having deducted any VAT.
2. Deduct the direct costs of materials that have, or will be, used in providing their services.
3. Deduct expenses met by the intermediary that would have been deductible from taxable earnings if the worker was employed.
4. The resulting amount is the deemed direct payment. If it is nil or negative, there is no deemed direct payment.

We then need to deduct tax and employee National Insurance contributions as appropriate from the deemed direct payment. Employer National Insurance contributions need to be deducted at this point.

By law we are required to report the pay and deductions you make to HMRC using a Full Payment Submission, as we do for workers on our payroll. We will indicate that this person is an off-payroll worker. You are required to keep records of any payments as well as amounts of Income Tax and National Insurance contributions deducted.

Be-IT are not responsible for Student loan repayments, holiday pay, statutory payments and auto-enrolment

We are not responsible for deducting student loan repayments for workers engaged through their own companies. The worker will account for student loan obligations in their own tax return.

As the worker is not one of our employees they are not entitled to:

- statutory payments
- be automatically enrolled into a pension

The worker’s entitlement to statutory payments comes through their employment with their intermediary. They can also contribute to a pension as an employee of their intermediary.

Workers providing services through intermediaries are also not entitled to employment rights, such as holiday pay under this legislation.

If a worker disagrees with a status determination

From 5 April 2021, an agent and a worker will be able to challenge a status determination if you think it's wrong. The client who made the determination will need to have processes in place for dealing with disagreements about determinations they make.

If the worker or the agency disagree, you must explain the reasons why you think the client's determination was wrong. Any evidence that supports the reasons for the disagreement should be presented.

The agency or the worker will need to write to the client to give reasons why they disagree.

The client will need to:

1. Consider any further information that you provide to them and reconsider the employment status determination.
2. Decide whether to maintain the determination because they feel it is correct and give reasons why or withdraw the determination because they feel it was wrong.
3. Respond to you within 45 days of receiving your disagreement.

The client will continue to apply the rules in line with their original determination until they respond.

What next?

For the moment there is no immediate impact on contractors or clients until we approach April 2021.

During November and December, we will be carrying out an audit on all workers to fully establish whether the assignment is Outside IR35, Inside IR35 or is Unclear. We will require client and worker involvement in this audit.

At Be-IT we are looking at defining our relationships with a number of trusted Umbrella organisations as this route is unaffected by the Off Payroll Legislation. We will also expand our Contractor payroll service to include Worker PAYE. We will update all contracts to reflect any changes in the legislation.

Above all, we will advise and consult with all of our contractors and clients individually to ensure full compliance to future legislation.