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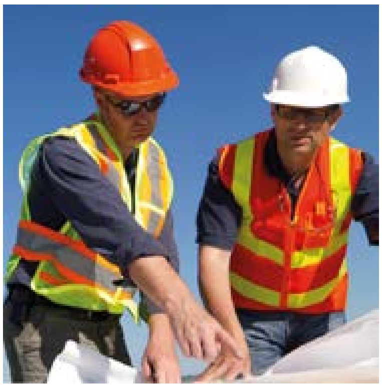

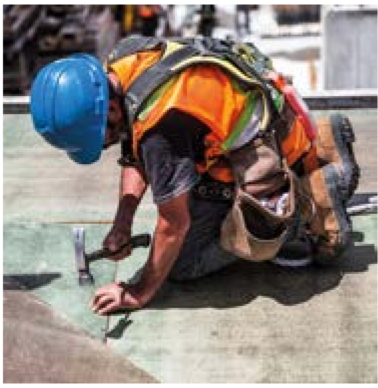

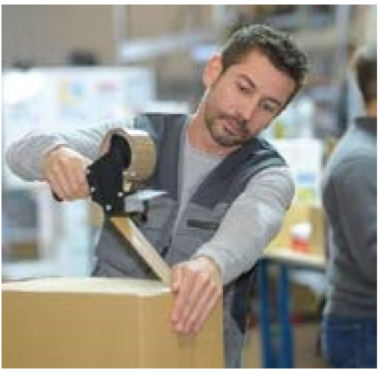

The Off-Payroll Working Rules

Reform IR35 in the Private Sector - A Guide

It has long been common practice for many contractors to provide their services to UK companies via their own Personal Service Companies (PSC).

As the end-client, historically this was a very simple way to obtain the services of contractors, either direct or via an agency, as responsibility for determining the tax status of the contractor (under the IR35 rules) was with the contractor themselves, and it was the PSC which had to pay the tax if that assessment was wrong.

This is, however, all about to change. From April2021, the rules around who is responsible for determining the tax status of these contractors under IR35 (and who is liable for tax if the determinations are wrong) are changing and may have significant ramifications for your business.

If you have not yet started to prepare for these changes, now is the time.

What are the Off-Payroll Working Rules?

IR35, sometimes known as the off-payroll work rules, is the set of tax rules that determines whether a contractor working through their own PSC (where the contractor will typically be the sole director and shareholder), is really a "disguised employee" who should be taxed as an employee. Historically, responsibility for determining whether IR35 applied was down to the contractor. If they got it wrong, they were liable for any underpayment of tax and NationalInsurance Contributions.

What is changing?

HMRC believe that the IR35 rules are often not being applied correctly and that this is costing the exchequer more than £1 bn each year. With contractors determining their own tax status, HMRC were struggling to address this as separate enquiries were needed into each PSC and each individual assignment.

In April 2017 HMRC therefore bought in reforms within the public sector that switched responsibility and liability for determining whether someone was a "disguised employee" from the contractor to the Public Sector organisation engaging them.

In the 2019 budget it was announced that these rule changes will be extended to medium and large sized companies in the private sector from April 2021. A large/ medium sized organisation is one which meets two or more of the following: over 50 employees, net turnover over £10.2m or a balance sheet over £5.1 m.

What does this mean for a private sector end-client?

From April 2021, if an end-client is a medium or large sized company and engages contractors direct via their PSC or the PSC is engaged further down their labour supply chain (via an employment agency or other intermediary), the end-client will be required to determine the tax status of the contractor for the engagement. Where the contractor is deemed to be an employee for tax purposes (as distinct from employment law purposes), the entity who pays the PSC will need to make all appropriate tax deductions.

What if the end-client is a "small" company?

If an end-client is a small company (i.e., does not meet two or more of the following: over 50 employees, net turnover over £10.2m ora balance sheet over £5.1 m) in the financial year for the business that ends before each tax year, they will be exempt from the new rules. It should be noted that where a company is part of a group it is the size of the overall group that counts.

How is the status determination reached?

Determining employment status of a contractor for tax purposes is not straight forward. The main principles to determine status are as follows:

1. Control
2. Substitution
3. Mutuality of Obligation

(ongoing obligation of end-client to offer work and of contractor to complete the work)

Other factors include whether the worker is taking any financial risk and have the ability to profit, whether they are really in business of their own accord, the nature of the job, nature of the contract, whether they appear to be part of the end-clients organisation and whether they are providing their own equipment.

Under the new legislation, the end-client making the tax status determination must take "reasonable care", which means that a blanket approach one way or the other is unlikely to beappropriate. The determination should be made prior to the start of a new engagement.

Once the determination has been made, the end-client must then confirm the IR35 status of a contract by providing a 'Status Determination Statement' (SDS) in writing to the PSC worker and, if an Agency is involved in the labour supply chain, a copy must be provided to the Agency.

The SDS will not only confirm whether the engagement is under IR35, but also the reasons why this conclusion has been reached. The Agency will then be responsible for passing the SDS on to any other intermediaries in the labour chain.

What HMRC guidance is there?

HMRC developed an on-line tool called Check Employment Status for Tax (CEST) in 2017 to help employers determine employment status. The CEST tool is available here:

Check Employment Status For Tax

HMRC have said they will stand by the result of this test, provided the responses are to the best of your knowledge, accurate and pertaining. To that individual and that assignment.
You should, however, reassess if there are any changes to the role orthe way in which the work is delivered. As per the HMRC website, however;

> **"HMRC won't stand by results achieved through contrived arrangementsdesigned to get a particular outcome from the service. This would be treated as evidence of deliberate non-compliance with associated higher penalties."**

Unfortunately, there has been much criticism of the CEST tool. Not only does it not factor in all the criteria established by case law (in particular it assumes Mutuality of Obligation) but it is also regularlyunable to determine a result one way or another.

What happens if the contractor disagrees with the status determination?

The contractor will have a legal right to challenge a determination and the end-client is responsible for establishing arrangements to consider any disputes and respond in writing within the 45 day time limit whether the original determination is to be upheld or changed and the reasons why.

If someone is deemed inside IR35, does that make them an employee?

It is important to remember that the issue of employment status for tax purposes is separate from that for employment law purposes. Inevitably any determination of status for tax purposes maylead to questions as to the individual's employment status and any employment rights which might follow as a result.

Who is liable for tax if HMRC challenge the status?

Under the proposed IR35 legislation, the company who pays the PSC will normally be the liable party if the PSC is determined by HMRC to be under IR35. An end client, however, may still be liable inthe following cases:

- HMRC determine that the end-client decision that a contractor is outside IR35 was unreasonable and taken without due care.
- The end-client did not pass the SDS on to the worker (and if applicable, the Agency).
- The end-client did not respond to the contractor determination challenge within 45 days.
- It is also possible that the end-client may be liable if HMRC are unable to collect taxes from other parties in the labour supply chain (e.g., the Agency) (the liabilitypasses back up the chain in this situation).
- If the end-client fulfils their own obligations, but another intermediary in the chain does not pass on the SDS, that intermediary will be liable.

What questions might contractors have?

It is likely many contractors will be concerned about the upcoming changes. Questions you are likely to be asked include:

- Is my engagement outside IR35? When will I know this?
- If not, is there anything we can change to make it outside IR35?
- If not, can I negotiate an increase in my rate?
- What other payment options are available if I can't be engaged via my PSC?
- Can I find work at a "small" company who are outside the scope (for example a subcontractor)?

How can an end-client prepare?

The upcoming changes are complex with significant risks if not managed properly.

Some organisations will react by issuing a blanket ban on PSC engagements, and indeed some of the larger banks have made statements to this effect.

The lesson, however, of the changes in the public sector, is that such approaches will result in an exodus of contractors causing projects to grind to a halt and a resulting increase in cost as the contractors are replaced.

What we would recommend is that you consider the following actions:

Understand

- Understand your labour supply chain and understand where liability sits.
- Identify the PSC's that you pay either direct or via your labour supply chain.
- Assess the risk to your business if some / all these contractors were to leave.

Prepare

- Design your compliance process to make the determinations and issue the SDS.
- Identify any key longer-term contractors who you may wish to take on your books.
- Prepare SDS assessments for all incumbent PSCs.
- Review contractual agreements and amend as necessary to clarify if inside / outside IR35.
- Identify other payment methods you or your labour supply chain can offer (e.g., PAYE, Umbrella).
- Communicate your plans with your contractors and labour supply chain.
- Arrange training of relevant internal staff.

Implement

- Issue SDS assessments to all contractors / agencies.
- Issue SDS for all new roles from April 2021.

How can Workforce on Demand help?

- Partner with us to attract and retain genuine contractors outside of IR35.
- There is no need for blanket bans or PAYE only policies.
- We will work with you to determine contractor status via our insurance backed, online status determination portal.
- We will insure against risk of misclassification with all legal costs and penalties covered.

To find out more about what we can do to help, please contact us today on 0191 4814124

Or email: Info@workforceondemand.co.uk

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