

IR35 and the changes to off-payroll working

March 2020

Matthew Clayton
Partner, Willans LLP

Caroline Harwood Benham
Partner, Crowe U.K. LLP

Jonny Hiles
Director RPO & MSP
Sanderson Recruitment plc



What is IR35?

- Legislation to prevent tax avoidance by ‘disguised employees’
- ‘Disguised employees’ – bear the hallmarks of an employee, but operate as companies to reduce the tax & NI they **and their client** pay
- Also known as the ‘intermediaries legislation’ and more recently the ‘off-payroll working rules’

Intermediaries

IR35 applies to individuals operating through a limited company. Can be referred to as:

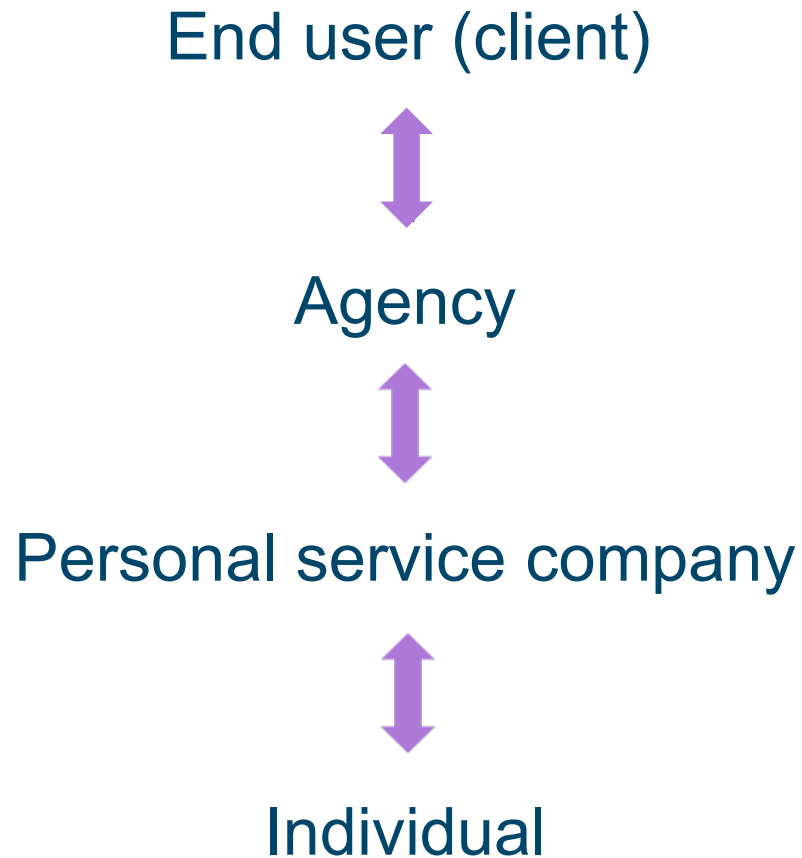
- intermediaries
- limited company contractors
- personal service companies (PSCs)

Can also apply to some partnership intermediaries

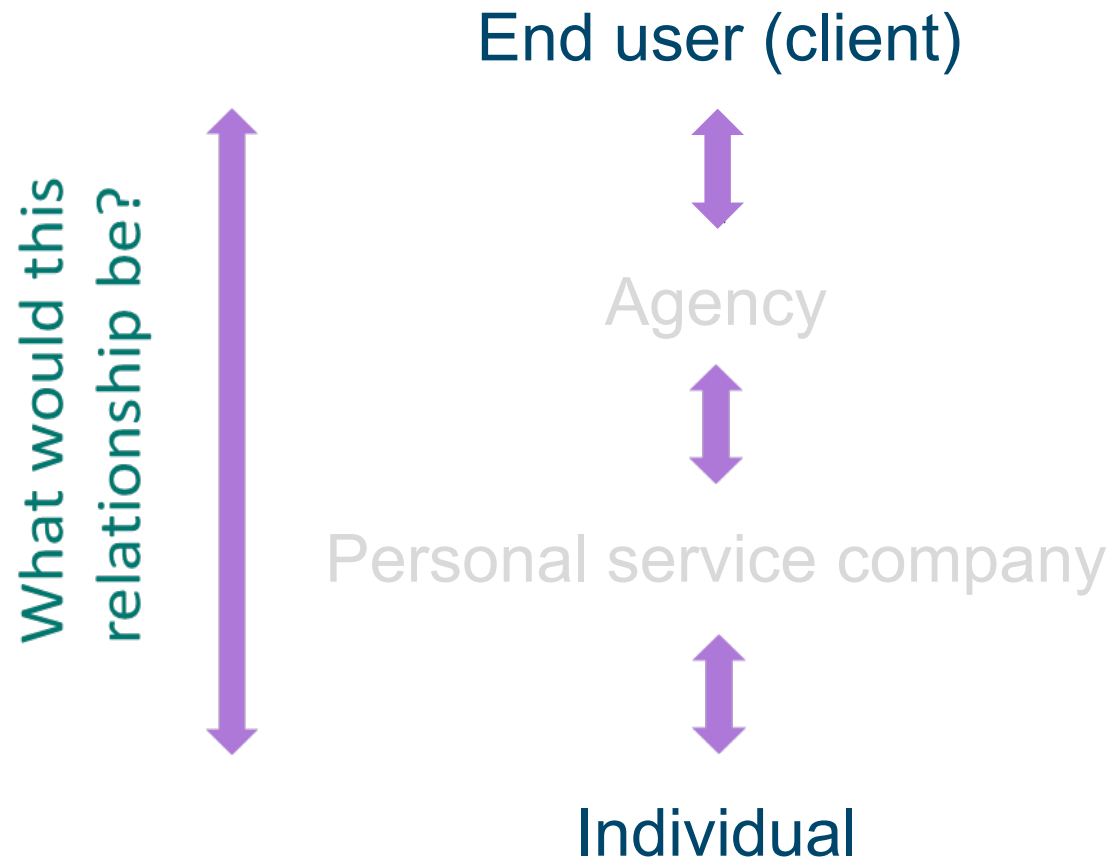
How does IR35 work?

- Hypothetical contract – not just the actual contract
- Looks at the actual relationship between worker and end user
- Based on case law and precedent
- A business or person is not caught by IR35 - but an engagement can be

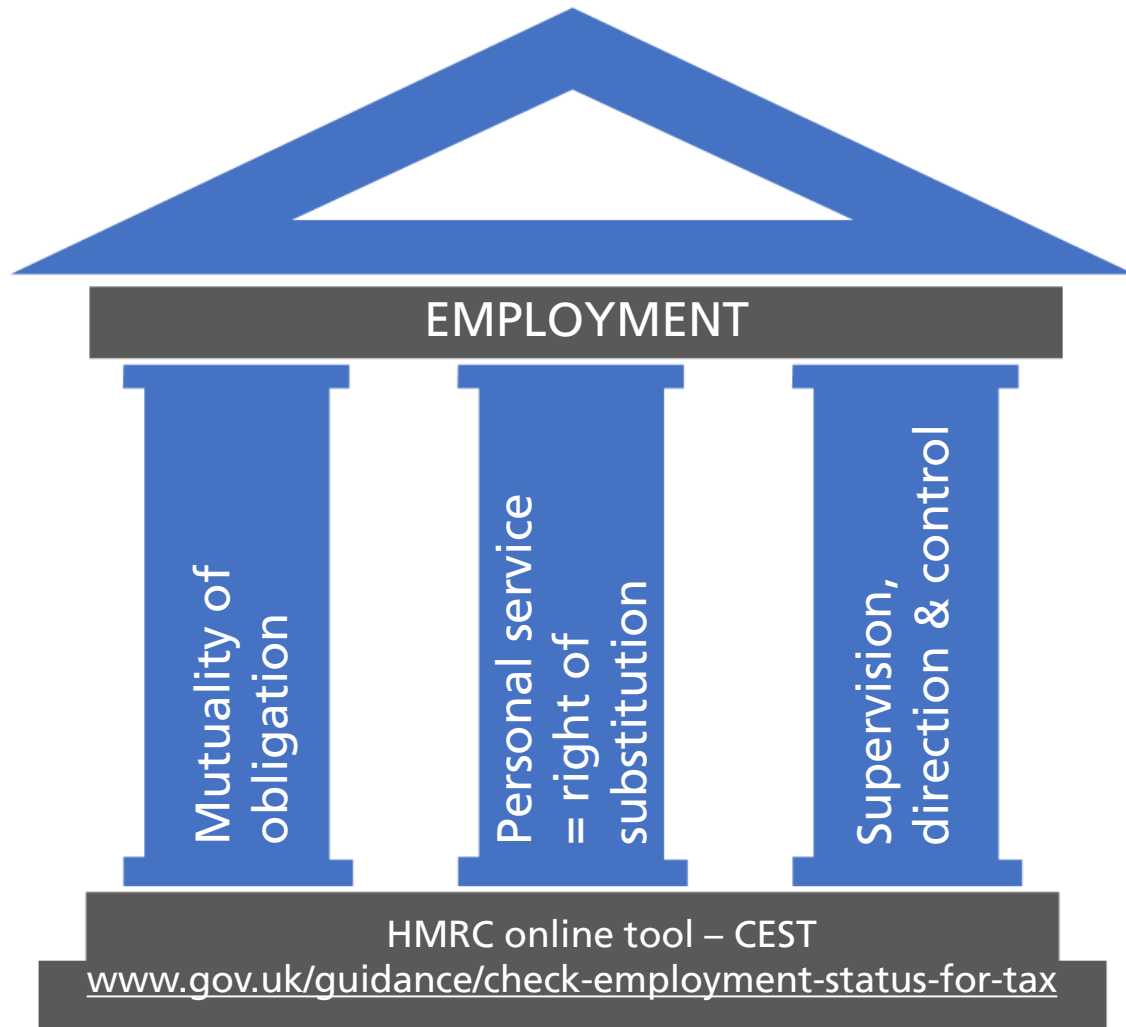
How does IR35 work?



How does IR35 work?



Employment - the 'irreducible minimum'



Mutuality of obligation

- The obligation on the employer to provide work and on the employee to perform it
- Often the most heavily contested aspect – any contract for work implies a mutual obligation
- Notice period suggests MoO exists
- MoO question often encountered re casual workers
- Question is then whether MoO exists in the gaps between assignments
- HMRC will often try to focus on the period of the assignment itself

Personal service - substitution

- An aspect of mutuality of obligation
- Do the services have to be provided personally by the worker?
- Unfettered right to substitution
 - does the client have the right to reject the substitute?
- Magic bullet?

Direction and control

- Is there a **right** of control, even if not exercised in practice?
 - master/servant relationship
- Setting the task vs. how to deliver it
- Whether supervision/direction/control is exercised is less relevant in highly specialised services
 - absence of control not fatal to employee status in such circumstances

Other factors

Is the contractor in business on their own account?

Is the contractor integrated into the organisation?

Does contractor receive employed benefits & perks?

Does contractor provide their own equipment?

Does contractor bear financial risk?

Form versus substance

What happens in practice matters more than what the contract says might happen, if in fact it wouldn't:

" ... if the reality of the situation is that no one seriously expects that a worker will seek to provide a substitute, or refuse the work offered, the fact that the contract expressly provides for these unrealistic possibilities will not alter the true nature of the relationship. But if these clauses genuinely reflect what might realistically be expected to occur, the fact that the rights conferred have not in fact been exercised will not render the right meaningless."

UK Supreme Court, Autoclenz Ltd v Belcher & others, 2011

Practical steps

- It's still worth looking carefully at contractual terms
 - client-intermediary
- Include a right of substitution
- Avoid an obligation to provide and accept work
- Avoid a notice period, if possible
- Intermediary to set time, place & method of work
- Structure by reference to completion of project

Practical steps

- Financial risk and reward
 - insurance requirement
 - penalties/bonus for early/late completion
- No 'employee-type' benefits
- Not subject to employment policies & procedures
- Provide own equipment (if possible)
- State that relationship is not intended to be one of employment
 - but remember – this is not determinative in itself

Effect of IR35 applying

- HMRC looking for tax which would have been due if the engagement had been employment
- Prior to 'off payroll working' rules, the PSC had to account for tax & NI as if for employed earnings
- Employer's NI is in the equation, but the PSC pays it – a **big** consequence for the contractor
- 5% allowance

The 'off-payroll working rules'

Public sector changes – April 2017

- Responsibility for determining IR35 shifted to public authorities
- If IR35 applies, the fee payer must deduct tax & NI

Private sector changes – April 2020

- Apply only to end users (clients) which are medium or large entities
- Client must determine if 'inside' or 'outside' IR35
- If 'inside' IR35, the fee payer must deduct tax & NI

IR35 – your journey to April 2020

How can you prepare for the changes to off-payroll working rules?

Caroline Harwood, Partner, Head of Employment Tax

5 March 2020



Objectives

This section of this part of the seminar will provide an overview of the practical implications of the new off-payroll working rules and what they will mean.

This should give you the tools to:

- identify key stakeholders and off-payroll workers
- assess your risk and organisational needs
- plan for change

Agenda

- Understanding the current rules
- Changes from April 2020
- What to look for in the intermediary
- The steps to take in practice if IR35 applies
- Anticipated impact on cost, systems and compliance
- Where to get help

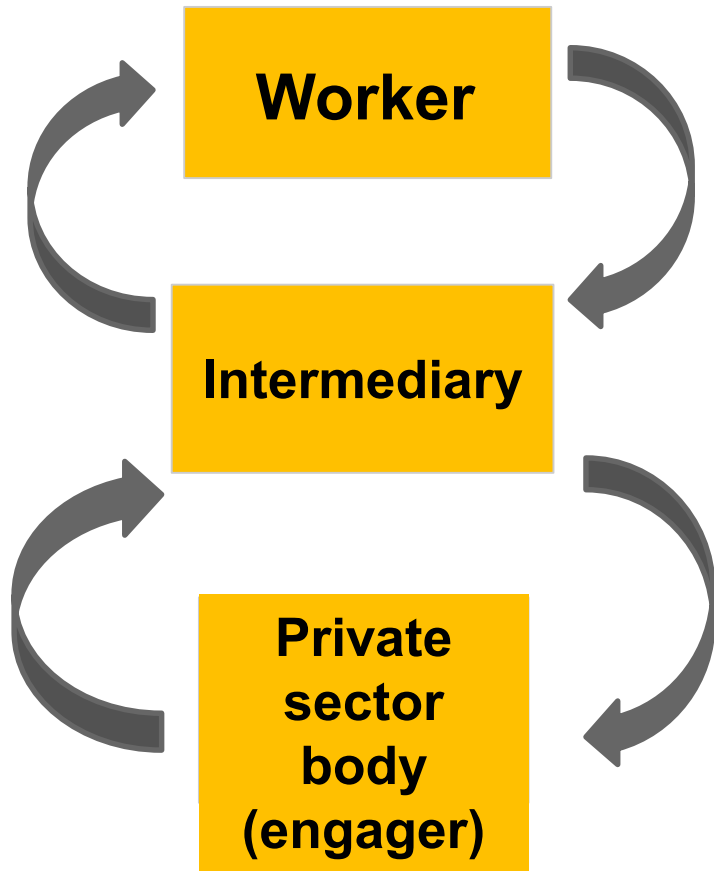
The current position

What is IR35?

IR35 refers to a set of tax and NIC rules which apply when:

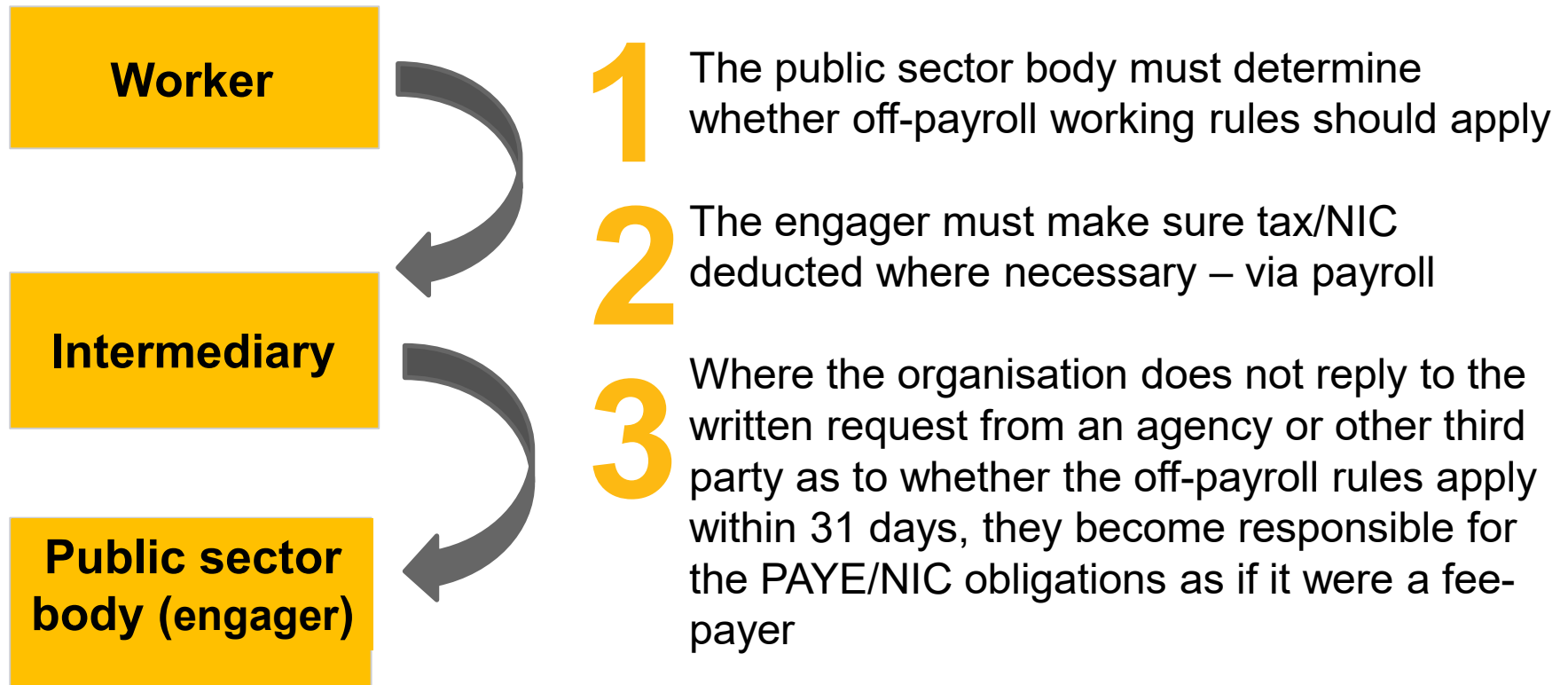
- an individual performs services for a client under an arrangement involving an intermediary, (commonly a personal service company), and
- if the arrangement had been made directly between the individual and the client, after considering the employment status indicators, the individual would have been treated as its employee.

Current private sector rules summary



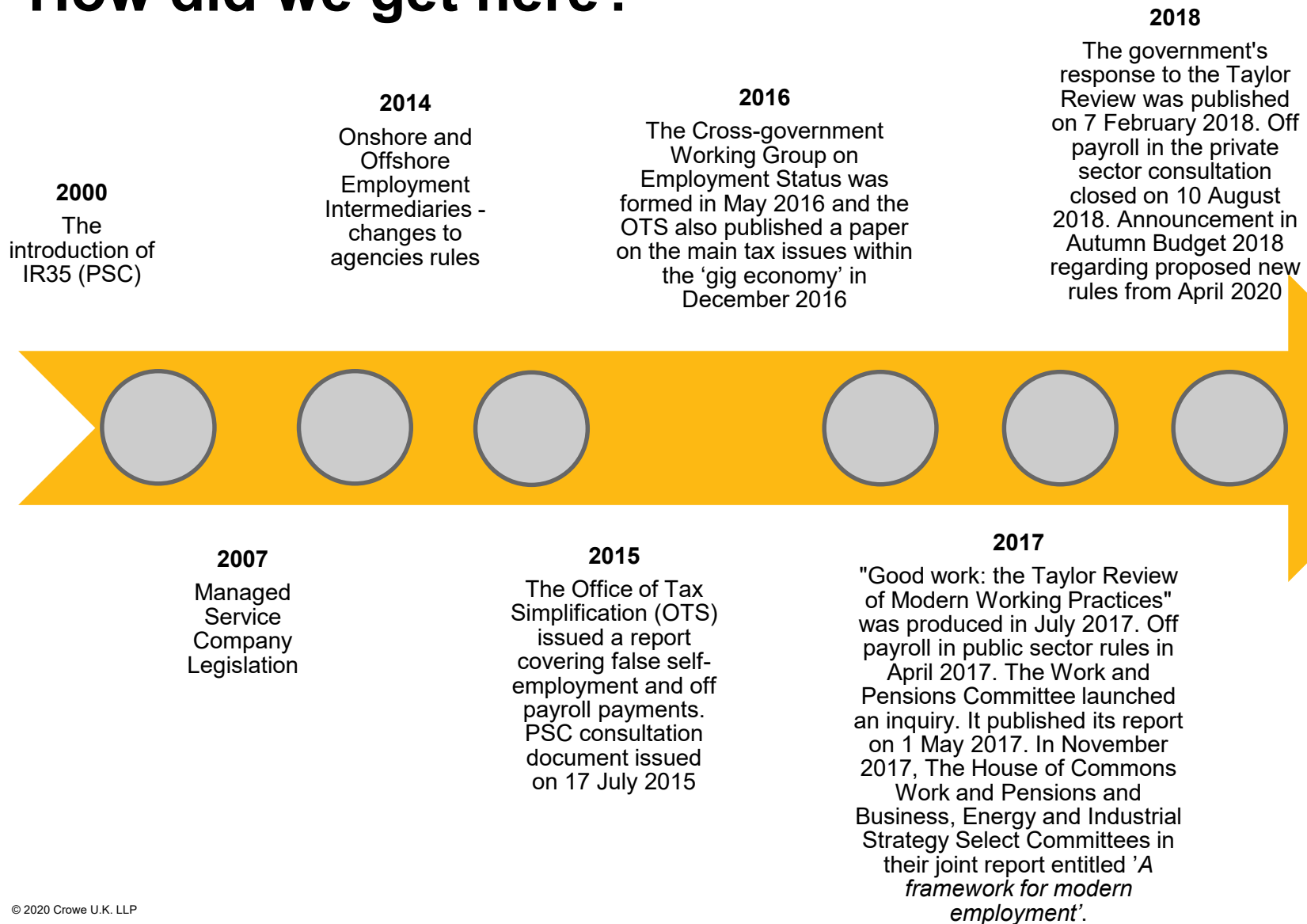
- 1 The intermediary decides the worker's employment status for each contract
- 2 If IR35 applies the intermediary calculates the "deemed employment payment" which is deemed income of the worker
- 3 Int. pays Er's NIC to HMRC, and pays any tax and the employee National Insurance contributions due, at the end of the tax year
- 4 Factor into payments of Corporation Tax, dividends or operating the Construction Industry Scheme
- 5 The worker must report information about these engagements to HMRC on their Self Assessment tax return, pay any other Income Tax and National Insurance contributions due

IR35 – public sector process from 6 April 2017



Where agency supplies the intermediary, the agency will operate any tax/NIC due

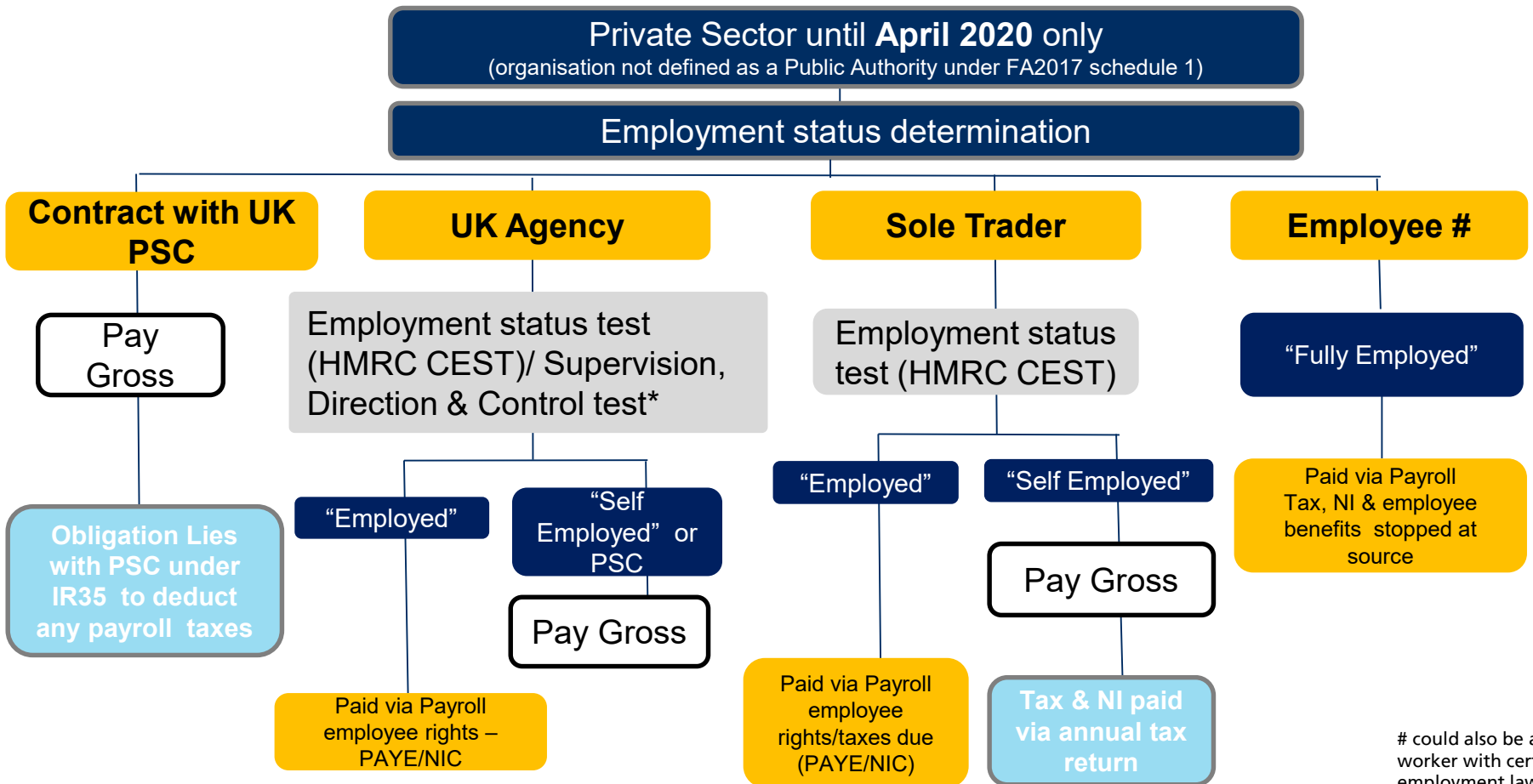
How did we get here?



Current Rules: Private Sector Decision Tree

*It is necessary to consider whether a worker is under the supervision, direction or control (SDC) of their client in order to determine:

- The employment status of a worker.
- Whether the agency rules apply to that worker.
- Whether, from 6 April 2016, tax relief on the costs home to work travel and subsistence are restricted for workers engaged through an employment intermediary. [HMRC guidance](#)



could also be a worker with certain employment law rights

Changes from April 2020

The important changes

- Off payroll rules that apply to the Public Sector will now be extended to private sector from **6th April 2020**
- Broadly speaking, the rules will require the private sector businesses impacted to identify and review the employment status of all workers engaged through personal service intermediaries (referred to hereafter as personal service companies or PSCs) including those provided via an agency or third party.
- If the worker is working like an employee, they are treated as a deemed employee of the 'fee-payer' for tax and NICs purposes.
- The reform will **not** apply to 'clients' who are small. However, the size of any agency or other party in the labour chain is irrelevant.

Who is small?

- Determining whether a client is small depends on the type of entity they are.
- **Companies and Limited Liability Partnerships** (Companies Act test) will be small unless, for two consecutive years, it meets two or more of the following criteria:
 - Turnover of more than £10.2 million
 - A balance sheet total of more than £5.1 million
 - An average of more than 50 employees
- **Most other entities** (turnover test) will be small unless their turnover is more than £10.2m for the last financial year ending at least 9 months prior to the beginning of the tax year.
- **Entities that are connected or in a group should be aggregated for the purposes of the above tests.**

Labour supply chain – who is who?

Client/Engager

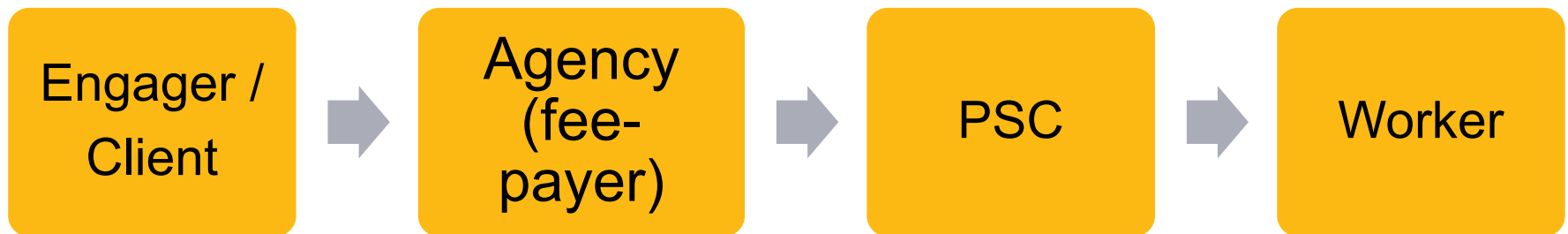
- This is the person who is receiving the services of the worker
- Has to make the status determination

Fee-payer

- This is the person who pays the worker's intermediary
- Has to operate PAYE/NICs if IR35 applies

PSC

- This is the worker's intermediary



Labour supply chain – who is who?

If the client pays the worker's intermediary, they are also the fee-payer and responsible for operating PAYE/NICs on the payment made to the worker's intermediary.



Summary of the changes from April 2020

1 Size – private sector

Turnover > £10.2 million

Balance sheet > £5.1 million

Employees >50

Meet 2 conditions in 2 consecutive years

Unincorporated – Turnover test only for one **financial** year.

Worker can ask about size – must respond in 45 days

2 Provision of information

The engager must issue a written Status Determination Statement setting out their rationale.

Pass a copy to the worker, the PSC and any other intermediary in the chain

Must take reasonable care (see HMRC guidance)

3 Disagreements

Put in place a Status Disagreement Process

Respond to disagreements within 45 days

HMRC will not be involved in the dispute

HMRC guidance on obligations for dispute process.

4 Non – compliance

Where the fee-payer fails to operate PAYE, HMRC can collect the appropriate tax and NICs from the client or first agency in the chain

(More on this later!)

**The intermediary – is it
within the scope of the
legislation?**

Who does it apply to? What types of intermediaries?

Condition A - Personal Services Company (PSC) – Section 610

Individual, associate or family member (can include unmarried partner) who:-

- **Controls**, or has the ability to control, more than 5% of the ordinary share capital of the company directly or indirectly: or
- Has, or is entitled to acquire, **rights** to receive more than **5% of any dividend** from the company; or
- Possesses or is entitled to acquire, **rights** over more than **5% of the assets** that would be available for distribution if the company is wound up (close companies only); or
- Receives or could receive, **payments or benefits** directly or indirectly from the intermediary which aren't employment income, but could reasonably be taken to represent payment for the service the individual provides to clients.

Who does it apply to?

What types of intermediaries?

Condition B - Partnerships –Section 61P

- Individual or family member (can include an unmarried partner) are entitled to 60% or more of the profits of the partnership; or
- All or most of the partnership's income comes from providing services to a **single client**, or to a single client and its associates: or
- The **profit sharing arrangements** in the partnership are designed to ensure that the individual receives an amount based on the payment received for services to clients for engagements within the IR35 legislation.

Condition C being an individual is an intermediary – Section 61N(11)

- Individual receives, or could receive, **payments or benefits** that could reasonably be taken to represent payment for the services the worker provides to clients.

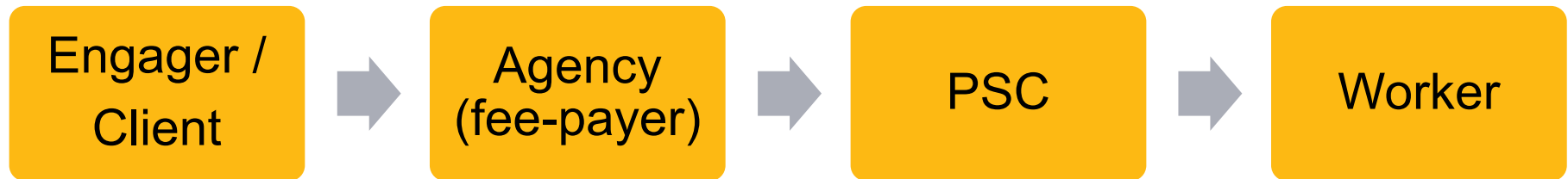
Employment Status

Check the nature of the engagement

- Follow the principles discussed by Matthew Clayton
- Establish whether the relationship is in the nature of “employment” or not
- Consider the use of CEST as a “triage” mechanism
- If the result is uncertain then investigate further
- If IR35 applies then the following steps will apply

IR35 applies: what do you need to do?

Labour supply chain – a quick reminder



What are the consequences for the fee-payer if rules apply?

- PAYE & NIC deductions to be made from Invoice value, net of VAT, and excluding cost of materials (but not home to work commuting costs) via payroll.

No obligations for the fee payer:

- Statutory Sick Pay
- Statutory Maternity/Paternity/Adoption pay
- Statutory redundancy pay
- NMW/LW
- Pension auto-enrolment
- Pension contributions
- Annual leave

Step 1: Check if you are the fee-payer

- The engager and fee payer can be the same party
- The fee payer must be the lowest party in the labour supply chain, usually the party paying the worker's intermediary (typically a PSC)
- A fee-payer must:
 - be resident in the UK, or have a place of business in the UK
 - Pay an intermediary that is controlled by the worker or associate of the worker
 - not be controlled, or material interest not be held, by either:
 - a worker, alone or with one or more associates of a worker
 - an associate of a worker, with or without other associates
- The client or agency above the fee payer will provide the Status Determination Statement (SDS)
- Without an SDS payments should be made gross of IT/NIC but ask.....

Step 1: Check if you are the fee-payer

Who is the fee-payer in these chains?



As the person who pays the PSC is non-UK, the fee-payer is the client as they are the next qualifying person in the chain.



As the person who pays the PSC is non-UK, the fee-payer is the UK agency as they are the next qualifying person in the chain.

Step 2: Communicate

- If you are the client, draft a Status Determination Statement (SDS)
 - Take reasonable care
 - Failure to do so will result in the worker's tax and National Insurance contributions becoming your responsibility
 - Take care with blanket determinations
- Pass the SDS and the reasons for the determination to the worker and all parties in the chain between the worker and the client
 - You are liable for tax and National Insurance contributions until you do so
 - If the working practices of the engagement change or you negotiate a new contract with the worker, re-check
- Have a Dispute Resolution Processes in place to deal with any disagreements as to status

Step 3: Deal with any disputes

If the worker or fee payer makes representations:

- review the reasons for disagreement together with any additional information
- decide whether the determination is correct:
 - yes - give reasons why
 - no - provide a new determination
- keep a record of your determinations, the reasons for them, plus records of representations
- respond within 45 days of receiving notification that the worker or agency disagrees with your SDS. Meanwhile operate in accordance with your original determination
- tell the worker if the determination has not changed
- tell the fee-payer and the worker if the determination has changed
- failure to respond within 45 days will result in the worker's tax and National Insurance contributions becoming your responsibility.

Step 4: Making the payments

- If you are not the fee payer make the payment without deducting tax/NIC
- If you are the fee payer:
 - a) calculate the “deemed direct payment” to account for employment taxes and National Insurance contributions associated with the contract
 - b) deduct those taxes and employee National Insurance contributions from the payment to a worker’s intermediary
 - c) pay employer National Insurance contributions
 - d) report to HMRC through Real Time Information the taxes and National Insurance contributions deducted
 - e) apply the apprenticeship levy and make any payments necessary

NB: The employment allowance cannot be used against payments to deemed employees

Calculating the “deemed payment” and making deductions – practical considerations

1. The deemed direct payment is the amount due to the worker after deducting
 - VAT
 - the direct costs to the worker of materials used/to be used in providing the services
 - expenses met by the intermediary that would have been deductible from taxable earnings if the worker was employed

If the result is nil or negative there is no deemed direct payment
2. Deduct tax and employee National Insurance contributions. Pay employer National Insurance contributions. Use normal payroll software or HMRC “Basic PAYE Tools” to determine the amounts.
3. Report the pay and deductions using a Full Payment Submission. Indicate that the worker is an off-payroll worker
4. You may (but don’t have to) add the workers to the existing payroll. If not a new PAYE Scheme will be needed
5. Keep records of any payments and amounts of Income Tax and NIC deducted
6. Correct errors in the normal way

Step 5: Securing your labour chains

- As mentioned earlier, where the fee-payer fails to operate PAYE, HMRC can collect the appropriate tax and NICs from:
 - The first agency in the labour chain (in the first instance); or
 - The client.
- However, HMRC **will not seek to do this** if the failure to operate PAYE by the fee-payer was as a result of a genuine business failure and they have not knowingly benefitted as a result of winding up without paying the tax.
- To protect yourselves from the potential liability, make sure you check who is in your labour chains and satisfy yourself that you are contracting with reputable and compliant organisations.
- HMRC have published guidance on these rules.

Interaction with other legislation

Interaction with other legislation

- **Agency legislation:** where an agency contracts directly with the worker as an employee and operates tax and NICs, or engages them on a self-employed basis but operates tax and NICs under agency rules, then the off-payroll working rules do not apply. (See Chapter 7, Part 2 ITEPA 2003).
- **Umbrella companies:** where an umbrella company employs the worker directly as an employee and does not contract with the worker's PSC, the off-payroll working rules do not apply. Some umbrella companies do not employ the worker directly and continue to contract with the worker's PSC - so these arrangements should be checked. If the worker's PSC continues to receive payments for the off-payroll worker's service through their PSC then the off-payroll working rules continue to apply.
- **Managed Service Company legislation:** where the conditions in the off-payroll working rules apply, these rules will take precedence over the managed service company rules in Chapter 9, Part 2 ITEPA 2003.
- **Construction Industry Scheme:** where the conditions in the off-payroll working rules apply, these rules will take precedence over the rules in the construction industry scheme.

What should you do now?

What should engagers think about?

What is your risk appetite?

What are your medium/long term plans for your business? International growth?

Do current supply models, and those of supplies, stand up to scrutiny?

A proper process of engagement and decision making

Remembering the answer can be different for employment law and Tax/NIC – employee/worker/self employed etc.

Paperwork

What to evaluate now in taking on consultants ?

Ensure processes are in place

- **Key stakeholders** need to understand all aspects of the new rules to successfully implement the changes required
- Discuss with **HR, Finance, Procurement, Tax and Legal** to determine the current process for establishing employment status, to understand the **end-to-end process** and perform a gap analysis
- **Consider** the governance framework and process, including Senior Accounting Officer (SAO), Corporate Criminal Offence (CCO) and applying reasonable care to underpin compliance

Identify any risk areas

- **Identify** the relevant populations affected by the changes
- **Perform a risk analysis** of employment status for each relevant contractor population
- **Understand** the implications of recent employment law developments regarding worker status (High/Medium/Low)
- Audit of third party suppliers / Contract review



What could the costs be ?

The financial impact of the changes may have an impact on:

- What is the impact if contractors are deemed to be employees?
- What might be the costs of compliance? e.g. **Employer NIC & Apprenticeship Levy**
- **Penalties** for non-compliance (light touch in the first 12 months)

- Costs associated with the **design and implementation** of system changes/adaptations
- Contractors may wish to renegotiate their rates / professional fees
- **Alternative resourcing or business process changes** should be identified and assessed – insourcing or outsourcing?

Existing Costs

System costs

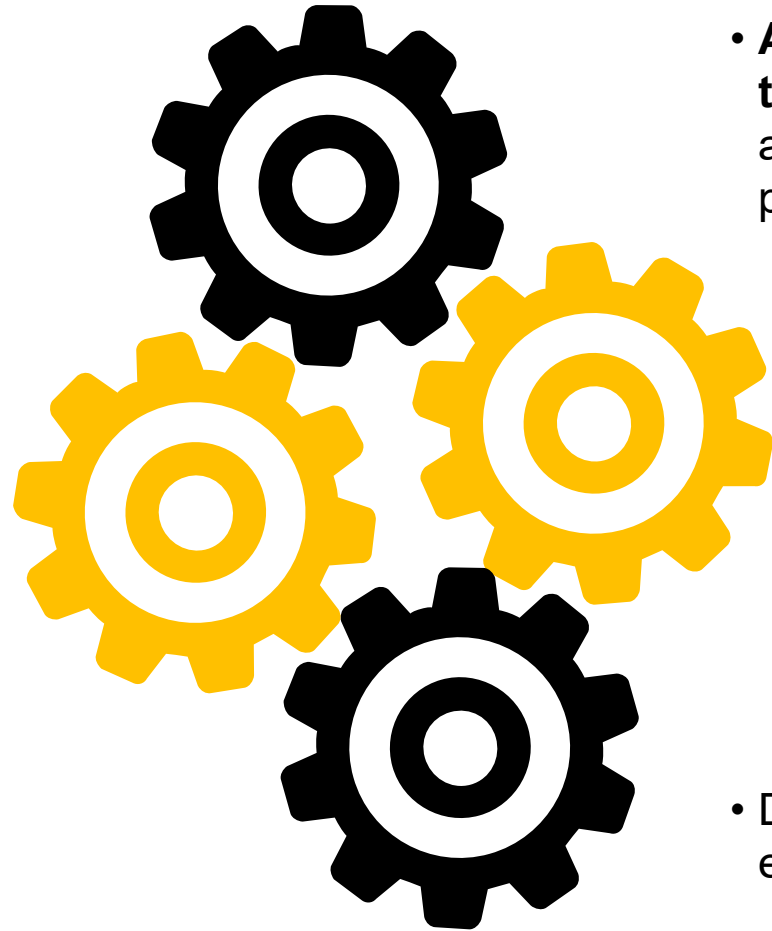
Tax at 20/40/45%,
ees NIC 12% +2%,
ers NIC 13.8%.

Interest c3% pa and
penalties up to
100% (usually 0 -
30%)

• What is your **current contractor spend**?

• How does this **affect any existing budgets and projects**?

Will system changes be needed ?



- **Assess** current systems and **plan for the design, testing and implementation** of enhancements or additional procedures to the existing systems and processes, such as:
 - Payroll changes
 - Third party supplier arrangements/Outsourced services
 - Roll out of policies, systems and processes
 - Data storage /GDPR
 - **Review the arrangements in place regularly**, taking account of changes in the fact pattern to help ensure ongoing compliance
- Do you need to provide **training** for those involved in engaging contractors and with facilitating payments?

Help

- HMRC provide detailed guidance on this topic
- Getting it wrong can be expensive for the organisation and potentially local budget holders
- Undertake risk analysis
- Determine whether your systems are ready
- Make best use of CEST
- If in doubt Crowe and Willans would be happy to help

IR35

Private Sector



Jonny Hiles
Director RPO & MSP



Sanderson
We're partners

IR35: What has happened to date?

Contractor UK

Contractors to make the most of IR35 reform's 12-month 'soft-landing'

Contractors hope that the Treasury's promise of off-payroll enforcement for the first 12 months being 'light-touch' will lead clients to 're-touch' their IR35 stances.

But it is just a 'hope,' not an expectation, as just over three-quarters of such PSC workers do not believe the 'soft landing' vow is going to prompt engagers to reassess their IR35 policy.

Computer Weekly

IR35 reforms: IT contractors warned off joining non-compliant umbrellas to avoid loan charge risk

Contracting stakeholders are calling on the government to do more to regulate umbrella companies ahead of the IR35 private sector reforms coming into play, to prevent more contractors falling into the scope of the loan charge

FT Adviser

Treasury pledges 'light touch' as IR35 reforms confirmed

The Treasury has promised a "light touch approach" to IR35 penalties in the coming year as it pushes forward with its reform in a move branded "disappointing albeit unsurprising".

Accountancy Daily

IR35 implementation review commits to April 2020 start date

With weeks to go until the IR35 rules come into force, the government has released the findings of its off-payroll review, with no backtracking on initial plans

The review was launched by former chancellor Sajid Javid in January but focused only on implementation issues despite calls to defer the introduction by a year.

📅 27 Feb 2020

Contractor UK

Why IR35 doesn't have to be 'the death' of contractors

📅 02 March 2020 | Consultancy.uk

IR35 is a piece of legislation that allows HMRC to collect additional payment where a contractor is an employee 'in all but name,' something which many expect to have major repercussions for Britain's burgeoning gig economy. Dan Grim, Head of Talent Services at digital marketing agency Fresh Egg, explains why the upcoming changes "needn't mean the death of the UK's big business freelancers."

iNews

IR35 changes 2020: why new HMRC tax rules are feared by self-employed workers

New rules on how contractors and freelancers are viewed by HMRC could leave many worse off

Where are we now?

The Options...



CEST
3rd Party Individual Assessment
Determinations



Blanket Umbrella Policy



SOW



Employment

Where are we going?



A woman with blonde hair is looking out of a window, holding a white cup of coffee. The background is slightly blurred, showing what appears to be a city street with buildings and trees. The text is overlaid on the left side of the image.

2 years on... What happened in the public sector?

Impact of OPW implementation in public sector

- 76% of public sector departments lost highly skilled contractors
- 61% gave the specific reason of not wanting to work inside IR35

Initially all new roles were inside, however over time a balance has been achieved

- Rates across the IT and PPM skill sets have increased by circa 15%
- In 2019 jobs advertised within IR35 attracted 40% fewer applicants

The challenges of status determinations and the risks

- 'Reasonable care' needs to be taken in arriving at an SDS
- NHS Digital - £4.3m tax bill after HMRC challenged the CEST tool

Recommendations



Know your total talent landscape



Be agile



Increased administration and approvals must be accepted



Know your supply chain and foster supply chain partnerships



Succession plan – develop skills



Develop supply chain partnerships that will help you



Smart use of contractors

Keep up-to-date

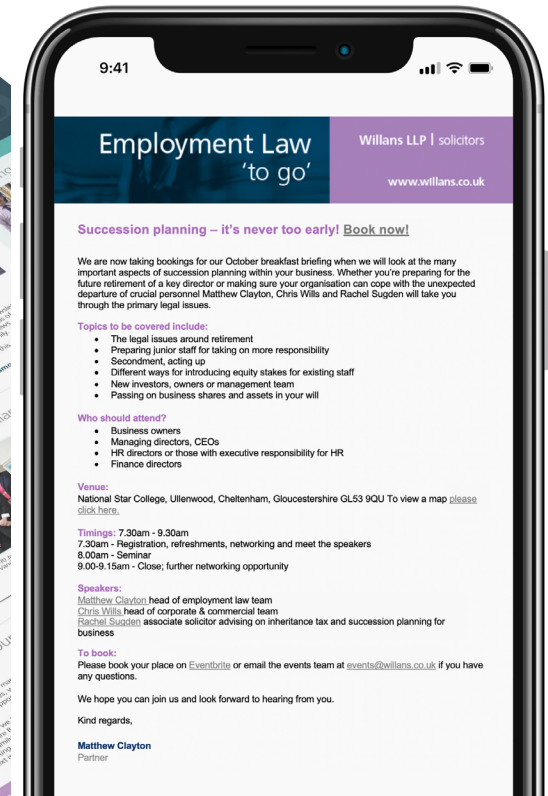
Sign up to receive relevant bulletins or hear about future seminars or training.

Subscribe

www.willans.co.uk/subscribe

Events & training

www.willans.co.uk/events



If you want to know more...

Please contact:

Matthew Clayton
Partner, Willans LLP

☎ : 01242 542922

✉ : matthew.clayton@willans.co.uk

in : www.linkedin.com/in/claytonmatthew



Jonny Hiles
Director RPO & MSP, Sanderson

☎ : 0117 907 4591

✉ : jonny.hiles@sandersonplc.com

in : www.linkedin.com/in/jonnyhiles



If you want to know more...

Please contact:

Caroline Harwood Benham
Partner, Crowe U.K. LLP

☎ : 020 7842 7274

✉ : caroline.harwood@crowe.co.uk

in : www.linkedin.com/in/caroline-harwood



Our 2020 seminar series

26 March | Employing non-UK nationals: your questions answered on business immigration | 9am-10:30am | Willans LLP, Cheltenham |
Space limited, email events@willans.co.uk if interested

20 May | GDPR: Two years on |
7:30am-9:30am | National Star College, Cheltenham | £18.50 (inc VAT & light breakfast).

16 June | Shareholder agreements for owner-managed and start-up businesses
| 8:30am-10:30am | Brickhampton Court Golf Club | £18.50 (inc VAT & light breakfast)

15 October | Autumn commercial and employment update |
9am-1:30pm | Brickhampton Court Golf Club | £50 (inc VAT & brunch)

To book visit www.willans.co.uk/events/ or email events@willans.co.uk for more information

CONTACT US

When you want the best outcome,
you need the best people.

COMMUNICATE

 +44 (0)1242 514000

 law@willans.co.uk

 www.willans.co.uk

VISIT

Willans LLP, solicitors
28 Imperial Square
Cheltenham
Gloucestershire
GL50 1RH, UK

CONNECT

 @WillansLLP

 Willans LLP, solicitors

 Willans LLP, solicitors



KNOWLEDGE HUB

Visit our Knowledge Hub for the latest
legal updates, news, events & training:
www.willans.co.uk/knowledge

