

Legislation changes in the private sector operation of IR35 – Q&A

1. What is the IR35 legislation?

The off-payroll working rules (known as IR35) were introduced back in 2000. While they are highly complex, their underlying aim is that anybody who works through an intermediary, for example a Personal Services Company (“PSC”) or Limited Liability Partnership (“LLP”), but who would be deemed to be an employee for tax purposes if they were not working through the intermediary, should pay similar taxes to other employees. The intention is to ensure fairness in the tax system.

In the Budget Statement on 29 October 2018, the Government announced its intention to reform the legislation around off-payroll workers in the private sector. HMRC then released a consultation paper about the reform on 5 March this year, further confirming its intention to mirror the reforms previously implemented within the public sector in April 2017; more recently, draft legislation was released on 11 July.

Further information is available from the following sources:

- Information from HMRC on Off-Payroll Working / IR35 can be found [here](#).
- A Factsheet from HM treasury concerning the extension to private sector can be found [here](#).
- Details from HMRC on the Off-Payroll Working arrangements in the public sector can be found [here](#).

2. Why has the government reformed the legislation?

It has been a long-stated intention of the government and HMRC to improve fairness in the taxation system. The IR35 rules were introduced so that where individuals are working for a company via an intermediary, such as their PSC, they should not be able to “sidestep” employment taxes or National Insurance Contributions (NICs) by working through such an intermediary.

However, the government believes that currently only 10% of people who should comply with the IR35 rules actually do so, and estimates that cost of non-compliance will reach £1.2 billion a year by 2023.

The government’s aim in making these reforms is therefore to tackle perceived high levels of non-compliance with IR35 among the self-employed within the private sector; these are similar to changes that have already been implemented in the public sector, but with some minor modifications following the consultation period.

Note that HMRC is keen to point out that the changes are about increasing compliance with existing rules – not introducing a new tax.

3. What is the definition of an Off-Payroll Worker?

An off-payroll worker is defined by HMRC as a person who provides a service through their own intermediary. The intermediary can be:

- A worker's own limited company – known as a personal service company (PSC).
- A partnership.
- Another individual.

Where the intermediary is a company, the individual needs to have a material interest in the intermediary for the rules to apply. Note that this does not usually affect workers engaged by an agency via PAYE or via an employed umbrella arrangement.

4. What changes will the legislation bring?

The draft legislation was issued on 11 July this year, with the final legislation due to be released later in the year. The changes will mostly mirror those introduced into the public sector in 2017, subject to some refinements. Essentially the changes are as follows:

- From 6 April 2020, medium and large businesses will need to decide whether the rules apply to an engagement with individuals who work through their own company. End clients which are small companies are excluded, but the definition of “small” is such that it is not relevant to our sector.¹
- The responsibility for assessing the employment status for a contractor's engagement will move from the PSC 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 is assessed as falling within IR35 (often referred to as being “caught by” or “inside” IR35), then the “Fee Payer” (the party contracting with the PSC) is responsible for making all relevant employer's 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, or if they have not used reasonable care in determining the status. However, End Hirers may pass on this liability through contract to the Fee Payer.
- The Fee Payer will be liable for unpaid taxes / fines if they do not process the payment in line with the End Hirer determination.
- The End Hirer will be required to implement a “client-led disagreement process” whereby a contractor can request a review of their status if they believe it to be incorrect.

5. When are the changes due to take effect?

Subject to Parliamentary approval and Royal Assent, the new rules will come into effect from 6 April 2020, and will apply to all payments on or after that date.

6. Is there a chance that if we have a general election the changes won't go ahead?

Given the legislation is still in draft form only, there is of course always a possibility that it will change, according to the priorities of any new government. However, we think it

¹ HMRC defines a small company based on the guidelines set out by the Companies Act 2006, which describes three main criteria in order to qualify as a small company:

- Annual turnover must not exceed £10.2 million
- Assets outlined on the balance sheet must not total more than £5.1 million
- No more than 50 people employed by the company

Should a company exceed the above conditions, it will then be considered either a medium or large company and will therefore be responsible for evaluating their contractors' IR35 status.

unlikely that a change in government would result in this legislation being significantly altered or shelved altogether, and we would not recommend holding off from any preparation owing to the political situation.

7. How will the assessment be made?

HMRC has developed its own online employment status testing tool “Check Employment Status for Tax” (CEST) to support organisations in determining whether the rules apply. Following negative feedback throughout the consultation, an improved CEST tool has been promised by the end of 2019, and HMRC also plan to publish updated new guidance and targeted communications to provide industry specific support.

End Hirers are not obliged to use CEST, but can instead use other ways to make the assessment, e.g. using a third party IR35 assessor or other tools. We are working with our clients to understand what processes they intend to implement, although we think it is likely that a number of clients will adopt a blanket approach.

8. I already deduct full Tax and NI in respect of payments from my PSC, so can I ignore the changes?

No. If the engagement is considered to be Inside IR35 moving forwards, responsibility for making the deductions will transfer from your PSC to the Fee Payer, irrespective of the manner in which your PSC currently operates. In this situation the overall financial impact of the changes may be less than would be the case if you were currently reporting as outside IR35, but there will be some difference.

9. Does the Fee Payer / private sector client have to offer employment protection to workers they deem inside IR35?

Being deemed employed for tax purposes does not currently confer any employment rights under the legislation, i.e. the definition of what is viewed as employment for tax purposes currently differs from that for conferring employment rights.²

10. Should contractors continue their assignment via their PSC if assessed as caught inside IR35?

You should seek independent advice on whether to retain your PSC for future engagements post-April 2020. Your accountant, tax or legal adviser should be able to help.

The public sector changes saw that many contractors changed their engagement model from PSC to either PAYE or Umbrella when assessed as inside IR35 for tax purposes. There were several reasons for this but overall it became less attractive to continue under their PSC because of:

- Reduced take-home pay owing to the tax deductions.
- Still a requirement to pay accountants’ fees, insurances and corporation tax.

² Last year the government issued a consultation on employment status (The Taylor Review of Modern Work Practices) that explored the case for aligning the employment status definitions across tax and rights, including whether those deemed to be employees for tax purposes, such as those within the Off-Payroll Working rules, should receive employment rights. Further information can be found [here](#).

- Concern over being exposed to HMRC investigation.
- No additional employment rights as a result of the tax status.

You should also bear in mind that for some clients it may no longer be possible to engage on a PSC basis.

11. Can changes be made to contracts to protect the PSC contractor from the legislation?

It is the actual working practices of the assignment that are important, rather than solely the contractual arrangements. The Client and the Fee Payer must comply with the legislation, as both are liable for incorrect assessments and tax. The employment status assessment must be based on the actual working practices and the contract must reflect these practices as well. This means that it won't be possible to make any changes to existing contracts to protect workers from this legislation unless the contractor's actual working practices change.

12. What are the other engagement models available to contractors?

The following are the options most likely to be suitable, should a contractor decide to change engagement model:

- PAYE – where the contractor is engaged on a PAYE basis by the agency and paid through the agency's payroll. (Note that this option is already available via APR.)
- Umbrella – where the contractor is an employee of the umbrella company, which is engaged by the agency. We are currently exploring what further support we can provide for contractors interested in engaging via this route.

Umbrella companies have acquired a poor reputation in the past, but a *bona fide* compliant umbrella company may still be a viable option for contractors. Beware of any "work around" schemes: if it seems too good to be true it probably is, and is most likely illegal. Sometimes these schemes will label themselves as "umbrella", but they are not umbrellas at all, and have brought the sector into disrepute.

13. Other potential concerns (Information from HM Treasury factsheet):

"Since the introduction of the public sector reform, and during consultations, the Government has listened to the views of stakeholders. On the basis of their feedback, it can confirm:

- *The reform is not retrospective. As was the case in the public sector, HMRC will focus on ensuring businesses comply with the reform for new engagements, rather than focusing on historic cases. HMRC will not carry out targeted campaigns into previous years when individuals start paying employment taxes under IR35 for the first time. Organisations' decisions about whether workers are within the rules will not automatically trigger an enquiry into earlier years.*
- *The reform will not stop anyone working through a limited company if that suits them.*
- *HMRC will provide extensive support and guidance to help organisations implement the Off-Payroll Working rules to ensure they apply them correctly. This will include the publication of detailed guidance for organisations and both general*

and targeted education packages, including webinars, workshops and one-to-one sessions with businesses in particular sectors.

- *HMRC continues to work with stakeholders to make improvements to CEST and wider guidance. Enhancements will be rigorously tested with stakeholders, and operational and legal experts, and will be available for use later in 2019.*
- *The vast majority of decisions in the public sector are made on a case-by-case basis, and the new client-led status disagreement process will allow the organisation's decision to be challenged in real time."*

Next Steps:

There is a lot of external press speculation on the approaches being taken by different companies. Most organisations are still working through the recent announcement and are yet to agree their position.

For the moment there is no immediate impact for contractors until the legislation is finalised and communicated. We will continue to monitor the legislation closely and work with our clients over 2019 to understand what process they will implement to meet their obligations – we will communicate further details as we learn more.

Although the new legislation doesn't come into effect until April 2020, we recommend that you start to consider the changes and speak to your accountant and / or a tax advisor about the potential impact on you well in advance of this change.