

Legislation changes in the private sector operation of IR35 - update for Contractors

Following our initial IR35 communication in September we are continuing to monitor developments in the market and are working with our clients to understand what processes they will implement to meet their obligations.

As we expected, it does appear that the precise approach will vary from client to client. However, a clear direction of travel for the sector has emerged based on the positions that clients have confirmed to date, coupled with our discussions with those clients who have yet to set out their official position.

We have held individual discussions with contractors as clients have communicated their stance and timelines, talking through specific situations and the options available. We want to ensure that all our contractors are kept up to date with developments to allow you to consider your options further and make sure you are well informed to make the appropriate decisions when the time comes. To date this has mainly been by phone, but we thought it would be useful to send out a further written update so that everyone is fully up to date.

In this update we will recap on the key issues and then look into some of the main considerations for contractors as you prepare for the changes. The article is necessarily lengthy – this is a complex topic, and there have been some potentially misleading comments in the market which we are keen to address. If you would like to refer to our original Q&A document you will find a copy [here](#).

A recap on IR35 and the April 2020 changes

Most of you will be familiar with IR35 and the upcoming changes by now, so feel free to skip this section, but the following recap may be helpful.

The IR35 rules (formally the Off-Payroll Working rules) were introduced in 2000, aiming to ensure that anybody who works through an intermediary (for most purposes this means a contractor working through a Personal Services Company (“PSC”)), 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. That’s a bit of a mouthful, but essentially it means that if you look like an employee you should pay tax like an employee, regardless of the mode of engagement.

The rules themselves are not changing, but what will change from April is the responsibility for assessing the tax status and the liability for deducting any payments due. In summary:

- 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”, who engages them. This means that the Hirer will have to assess the employment status of all workers engaged through a PSC, and is a change from the current situation, where the responsibility for assessing a contractor’s employment status for tax purposes lies with the PSC.

- If the assignment is assessed as being akin to employment (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 gross pay and paying these directly to HMRC.
- The 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.
- The Fee Payer will be liable for unpaid taxes / fines if they do not process the payment in line with the Hirer determination.
- The 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.

In most contexts the Hirer is the institution using the contract resource (the insurance company for most APR contractors) and the Fee Payer is the agency supplying the resource (eg APR).

The changes take effect from 6 April 2020, but relate to any **payments** made to contractors from that date. Given under most engagements contractors are paid monthly in arrears this means that in most cases ongoing arrangements will ideally need to be in place by the end of February at the latest.

What we are seeing from clients

There is a wide range in the levels of understanding and preparedness among clients, which is perhaps unsurprising given the complexity of the legislation. However, many of the larger clients have now stated their position, so the situation is becoming clearer. The following summarises the various views we are seeing from clients:

- There is a clear common theme that clients are keen to minimise their exposure to the risks associated with non-compliance with the tax regulations. Most are of the view that if assessments are made, the vast majority of contractors will be deemed to be inside IR35.
- Many clients have made the decision that it is more straightforward administratively, and lower risk, simply not to engage contractors via PSCs going forward, and that future engagements will need to be under some sort of payroll arrangement, either umbrella, PAYE or switching contractors to fixed term or permanent contracts.
- Some others are being less rigid and are planning to assess each engagement on its merits, using either the [Check Employment Status for Tax](#) tool “CEST” or a third party to make the assessment. Even for those clients, though, the clients’ expectations are that the arrangement will be deemed to be inside IR35 – if so, they will either insist on engaging under a PAYE arrangement or, in some cases, allow the option of deemed payment in the expectation that contractors will view it as administratively burdensome and costly, and opt to engage via PAYE.
- A small number of clients are exploring ways they can change arrangements with contractors so that they can demonstrate that the engagement is outside IR35, but this is generally only being considered for highly experienced contractors operating in a very niche manner. While there will no doubt be scenarios where this may be appropriate, we expect that these will make up a very small minority; to avoid future risks crystallising (for both clients and contractors), we are flagging to clients that they need to make sure a) that the actual working relationship is genuinely one of a service rather than employment, rather than just wording in a contract, and b) that they are comfortable with what this means in practice in terms of the service they are receiving.

We are still awaiting confirmation of the positions of a few clients, although there is no evidence that many will deviate too far from the views outlined above. We have also seen that some of those who stated their position early have started to modify their thinking slightly to reflect either contractor feedback or wider market movement (or both). For example, one client who was encouraging contractors to go down a fixed term contract (i.e. temporary employment with the client) approach, has now moved to expecting most contractors to switch to PAYE agency worker or umbrella. We expect that the majority of clients will have confirmed and communicated their position by January 2020.

Although firms are entitled to make policy decisions not to engage with PSCs, it is not permitted to make blanket Status Determination Statements (“SDS”) – i.e. if an assessment is being made it needs to be done on an individual basis. The fact that the assessment needs to be made on an ongoing basis and is open to challenge both from contractors and from others in the contractual chain, is leading most clients to take the view that it is too much hassle to go down this route. So while there are slightly mixed messages coming from different organisations, the general trend in the market appears to be moving firmly towards one of the PAYE options.

It’s also worth noting that the legislation is clear that it is the Hirer who needs to make the assessment. They shouldn’t be asking contractors to do so on their behalf, and we would be very wary of agencies who claim to be able to offer an all-in-one service to provide contractors with “outside IR35” engagements.

What are the on-payroll options?

A combination of the fact that we believe the majority of clients will only be willing to engage contractors on some sort of PAYE basis, and that where clients are willing to engage PSCs on an “Inside IR35” basis it’s unlikely this will be attractive to contractors, leads us to the view that one way or another most arrangements post-April will be under an on-payroll model. It’s therefore worth summarising again what these options are:

- **PAYE agency worker** – In this scenario the individual will be added to the payroll of another intermediary (normally an agency, for example APR – note this option is already one we offer). They will have worker rights but not full employment rights.
- **Umbrella** – In most cases individuals engaged under an umbrella arrangement will be permanent employees of the umbrella, and therefore benefit from full employee rights.
- **Direct employment by the client** – Under this approach, the contractor becomes either a permanent or temporary employee (the latter sometimes being referred to as “Fixed Term Contract”). This would mean the individual is added to the Hirer’s own payroll and they would be treated as any other employee, enjoying the same benefits and being remunerated under the same pay scales.

In all scenarios the individual will be paid net of PAYE tax and Employee National Insurance Contributions, and may have rights under the Agency Worker Regulations, the “Conduct Regulations” as well as statutory rights.

PAYE agency worker vs Umbrella – dispelling some of the myths

If current indications prove correct that most clients will only be prepared to accept contractors on an on-payroll arrangement, one of the key decisions for contractors is whether to engage as a PAYE agency worker with the agency or via an umbrella company.

There seems to be much confusion in the industry over the relative merits of these two options, with lots of misleading information flying around over what the differences are. We believe that part of the reason for the confusion / misinformation is that, in the actuarial space at least, most agencies don't currently offer the PAYE agency worker option, and so many clients were initially unaware that this route exists. That position seems to be changing, but the message has taken some time to filter down to the level of conversations between managers and contractors when discussing extension options.

To be entirely transparent, while we are able to engage with umbrella companies where this is the preferred approach by the contractor, from an administrative and governance perspective the PAYE agency worker route feels like the more straightforward, and therefore preferable, option – our conversations with contractors suggest that most, but not all, feel the same. However, we thought it might be helpful to set out our understanding of the differences (or rather in most cases the similarities) between the two approaches:

Hirer perspective	There is no great difference as far as the Hirer is concerned. Their contractual agreement is with the agency in either case, but under an umbrella arrangement there is another party in the contractual chain.
Method of payment	<p>PAYE agency workers will be paid a set day rate, specified in their assignment schedule. This is similar to the current PSC arrangement, albeit the payment is made net rather than gross.</p> <p>Under an umbrella arrangement the way some operate is that the agency pays an “all-in” rate (known as an assignment rate) to the umbrella, and the umbrella will pay a base salary at national minimum wage (or slightly above), with an additional bonus, or commission, payment of the sum remaining after the umbrella has deducted an amount to allow for employer NI, its margin and any other employment benefits. The umbrella company should lay out transparently what these deductions will be.</p>
Cost to contractor	<p>Most umbrellas charge a monthly fee, typically around £100.</p> <p>There is no cost to contractors of engaging on a PAYE agency worker basis.</p>
Employment status / rights	In most cases individuals engaged under an umbrella arrangement will be permanent employees, whereas under the PAYE agency worker approach they will have worker status. Employees benefit from more statutory rights than workers, but the differences aren't hugely significant (the main ones being minimum notice periods, protection against unfair dismissal and statutory redundancy pay).
Contractual position	<p>The contractual chain under the two models are:</p> <ul style="list-style-type: none"> • PAYE agency worker – Hirer > Agency > Contractor • Umbrella company – Hirer > Agency > Umbrella > Contractor; the contractor will also have a “work finding services” agreement with the agency. <p>In practice, for a PAYE agency worker this means they will have an ongoing candidate agreement with the agency (the name may differ for other agencies) with an assignment schedule for each engagement, similar to the current PSC contract arrangement.</p>

	<p>Under an umbrella arrangement the contractor will generally have an over-arching employment contract with the umbrella company.</p> <p>In both cases the contractual arrangements can be used to cover multiple assignments, but the main difference is that an umbrella employee is more closely tied to the umbrella company, whereas under a PAYE agency worker arrangement the contractor may need to have similar agreements in place with various different agencies to maximise flexibility in moving between roles.</p>
Tax treatment	<p>There is no difference in tax treatment between the two arrangements. All payments should be made through an approved PAYE payroll scheme, with tax and NI fully deducted at source.</p>
Treatment of expenses	<p>In the vast majority of cases home-to-work expenses will not be tax-deductible under either arrangement. Where genuine business expenses (for example travel between client sites) are incurred, these should be reimbursed by the client and are allowable.¹</p>
Non-salary benefits	<p>Under both arrangements contractors are eligible for holiday pay (which one way or another will be allowed for in the rate paid), auto-enrolment pension contributions and other statutory benefits.</p> <p>Both umbrella companies and agencies engaging on a PAYE basis can offer wider voluntary benefits or entitlements similar to what any employer might offer to employees. For some benefits these can be through an allowable salary sacrifice scheme, providing an additional NI saving.²</p> <p>Umbrellas and agencies may provide PI cover to actuarial contractors, but we are aware that several don't (this is something APR provides as standard).</p>
Accreditation	<p>The vast majority of clients are insisting that any umbrella used for engagements is accredited, in most cases by the FCSA; some even have a narrower list of approved umbrellas. The main reason for this is to give comfort that contractor remuneration is fully tax compliant (as there have been a number of issues in the past where this was not the case).</p> <p>As agencies engaging contractors directly make payments via payroll, all payments will have the tax fully deducted at source, and contracts with clients will generally explicitly provision for this.</p>

It's worth expanding on a couple of the points above in more detail:

Expenses (note 1)

There has been much talk of a potential advantage to contractors of engaging via an umbrella, in that they will receive tax relief on allowable business expenses and many umbrellas promote this as a key selling-point.

While in the past this has been a key benefit of the umbrella model, a change in legislation in 2016 (*s.339A Income Tax (Earnings and Pensions) Act 2003* for those that are interested) means that the vast majority of expenses are not tax deductible unless certain conditions are met, the chief of which is that it can be demonstrated that no party exercises, or has the right to exercise, Supervision, Direction and Control over the individual. We have serious doubts as to whether many clients would

be prepared to engage contractors without such control – this stands to reason, as intuitively the ability to exercise SDC is likely to be one of the significant influencing factors in determining that a contractor is inside IR35.

The result of these rules is that in practice there is highly unlikely to be any difference between the treatment of expense under an umbrella arrangement relative to a PAYE agency worker engagement, unless the umbrella company is engaged in non-compliant practices.

Salary sacrifice (note 2)

Another purported advantage of the umbrella route is the ability to increase take-home pay by taking advantage of a salary sacrifice arrangement. These arrangements work by allowing individuals to “sacrifice” some of their pay in exchange for benefits offered by their employer, so essentially paying for the benefits out of their gross salary. For most permissible benefits this will lead to reduction in the level of NI contributions the individual pays, and in some cases a reduction in PAYE tax as well (although most salary sacrifice benefits are now subject to income tax).

While the benefits themselves may be attractive, in terms of impact on contractors’ take-home earnings by far the greatest benefit would be in relation to pension contributions, where contractors could potentially make significant NI savings if contributions are large. Note that although the contractor will certainly benefit from reduced Employee NI contributions, it is entirely down to the employer as to what they do with the Employer NI savings – some employers will pass these on (in part or full) to employees, but in many cases they will retain it themselves as a cost saving, perhaps to fund the administration of the scheme itself.

A number of umbrella companies offer this sort of scheme, which is understandably quite attractive to contractors, but there is no reason in principle why an agency can’t offer an equivalent scheme to its PAYE agency workers. Most don’t do so currently as it’s not previously been considered a core aspect of their business, but as an example, it’s something that we are exploring as an option at APR with the intention that it will be in place by April.

One further point is that for the salary sacrifice scheme to be legitimate, the pension contributions can only be made into the arrangement specified in the scheme. This means that the contractor won’t be able to choose to use their own pension arrangement, which could be seen as an unwelcome constraint.

Direct employment

Finally, not to ignore the third possible on-payroll option of direct employment: while the Fixed Term Contract / Permanent options might be attractive in theory to many clients, it’s fair to say that most contractors we’ve spoken to are luke-warm to the idea, given this is likely to represent an even greater reduction to take-home pay, as most clients will be unable or unwilling to go outside existing pay structures. Many contractors have also mentioned that they value the flexibility and variety that contract work provides.

Impact on rates / expenses

A natural consequence of the fact that the changes will lead to an increase in tax revenue for HMRC is that there will clearly be a financial impact on Hirers or contractors (or both). Most clients have taken the stance that there should be no increase in rates to reflect the lower take-home pay for contractor; while it isn’t usually clear until the rates are finalised exactly what this means in practice, what is clear is that the effect on the take-home pay rate for contractors can be significant. We are

working with clients to understand what approach they will take to rates, with a view to providing PAYE illustrations to contractors as soon as we're able.

We do get the sense that while many clients are starting to adopt set positions on how they will deal with contractors, as the date of the change approaches, and probably beyond, there may well be some loosening of policy or flexibility around the rules, as clients seek to avoid the risk of losing key expertise on critical projects. Whether this simply leads to an acceptance that rates may need to increase, or that clients may be willing to undertake the SDS assessment in limited cases remains to be seen. Where the latter is true, there is of course still a high chance that the outcome will be that the contractor is inside IR35.

The reduction in pay can be further exacerbated by the loss of tax relief on expenses, as mentioned above. At present, most contractors will deduct the cost of working (such as travel and accommodation expenses) from the taxable profit of their PSC. In the vast majority of scenarios, such expenses will after April need to come out of net pay; and as contractors will no longer be operating via a limited company, there is also no mechanism for reclaiming any of the VAT.

Transitional arrangements

The process of moving from being a PSC contractor to a PAYE agency working is very straightforward once the client has finalised its stance on the way rates are calculated. For arrangements via APR, we will trigger the Notice to Terminate clause in your existing PSC Schedule in good time and provide you with a PAYE Candidate Agreement and Schedule in its place. Your ability to provide your services to your client should not be disrupted in any way.

Moving to an umbrella is a similar process in principle, but we need to have an agreement in place with the umbrella company, which will require some time and effort in terms of due diligence and the contractual process. The contractor will also need to have an employment contract in place with the umbrella company.

In terms of timings, remember that the date at which the updated legislation will come into force is 6 April 2020. After this date, if a contractor is deemed "within-IR35", APR will be obliged to withhold all appropriate taxes. For contractors paid monthly in arrears, this means that remuneration for days worked in March will be subject to the updated legislation; effectively making the true implementation date 1 March 2020.

Legislative position

It's worth noting that the final legislation has not yet been passed, and there is no saying for certain whether the new government will proceed with the existing plans. There was no mention of the changes in the Conservatives' manifesto, although they did state during the campaign that they would undertake a review. Given the significant additional tax revenues the changes are predicted to generate, along with the fact that the policy was originally introduced by a Conservative government, one might reasonably be sceptical about how likely it is they will review, or if they do whether this will result in a change of direction. One possible outcome is that the new requirements will be set back until the following year, which may be welcome to some, but could just add a further period of disruption and uncertainty. Perhaps more likely is that the legislation will be passed, but rushed through without the level of scrutiny needed to remove some of the wrinkles that still exist – to some extent this was the case when the changes were introduced in the public sector in 2017.

Next steps / action

We understand that individuals will be at different stages depending in the main if your current organisation has decided on their stance and implementation process.

We continue to monitor the legislation closely and are also working closely with all our clients to understand what processes they will implement to meet their obligations.

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 as soon as possible, and certainly well in advance of the changes to ensure you are well informed to make the appropriate decisions when the time comes.

We would be very happy to discuss the changes further with you individually at any stage.