

IR35 in the private sector - FAQs for companies engaging contractors

From 6 April 2021, most private sector companies who engage limited company contractors, whether directly or via an agency, become responsible for determining the tax status (known as 'IR35') of those assignments.

Legislation and further guidance will be released in the coming months. However, we know the changes will be broadly the same as the 2017 public sector changes to IR35, and we urge companies to start work **now** to reduce the disruption associated with such wide-ranging reform.

1. What is IR35?

IR35 refers to HMRC's 'test' for self-employment for **tax purposes only** when contractors work via their own limited company (or limited partnership), normally referred to as a personal service company or PSC. Working through a PSC does not, in itself, dictate that a contractor is self-employed.

The test states that a PSC contractor is not considered to be self-employed if the working arrangements of the assignment indicate that the contractor would be considered an employee for tax purposes if he/she had been engaged directly, with no PSC in the chain.

In those circumstances, the PSC contractor is determined to be 'Inside IR35' or 'caught' by the IR35 rules, and must pay income tax and National Insurance Contributions (NICs) on the entire assignment income, just as an employee would. Where the working practices of the assignment indicate a truly self-employed engagement, the assignment is considered to be 'Outside IR35' and the PSC is entitled to treat the income differently (in the form of dividends for example).

It is important to note that any PSC contractors who are deemed to be 'Inside IR35' are considered to be 'employees' for **tax** purposes only. There is no change to the PSC contractor's status in terms of employment **rights**.

Furthermore, IR35 **only** applies to contractors who operate through a PSC. The rules do not apply to PAYE contractors, umbrella contractors or sole traders. If you do not engage PSCs, your business will be unaffected by the changes.

2. How is IR35 status determined?

While the basis of IR35 is relatively simple, its application is not. The criteria that dictates what is 'Inside IR35' or 'Outside IR35' is not included in the regulation itself, instead relying on decades of case law and employment status tests to flesh out the detail.

The result is a complex, often highly subjective and case-specific test that is difficult to interpret and apply. There are more than a dozen indicators of IR35 status; the three most influential factors are: Mutuality of Obligation, Control and Personal Service. We have compiled an overview of the key factors that dictate IR35 status; please ask us for a copy.

3. What are the current IR35 rules (pre-2021) in the private sector?

The original IR35 legislation, and how it applies in the private sector until April 2021, requires the PSC contractor him/herself to assess each assignment for IR35 purposes and make the appropriate deductions for tax and NI (where applicable). Any liabilities for misclassification of IR35 also sit with the PSC alone; any agencies or engagers / end clients have no liability under the IR35 rules in the private sector.

4. What are the new IR35 rules?

The new rules will be broadly similar to the changes made in 2017 to public sector bodies engaging PSC contractors. We do not yet have the technical detail or legislation on the new rules for the private sector, but this is what we know so far.

From 6 April 2021, all companies who are not classed as 'small' businesses who engage PSC contractors, whether directly or through an agency, become legally responsible for assessing the IR35 status of each assignment. The liability for deciding whether an assignment is 'Inside IR35' or 'Outside IR35' therefore moves from the contractor to the end user.

Before the start of an assignment (or before 6 April 2021 for any assignments started before 6 April but continuing past that date), the end user of the PSC's services must inform the agency or PSC of the IR35 status of the assignment. When undertaking the assessment, businesses are required to take 'reasonable care'.

If an assignment is assessed to be 'Inside IR35' then income tax, Employee's National Insurance and Employer's National Insurance becomes payable on all income derived from that assignment.

Whoever pays the PSC must make the appropriate deductions for income tax and NI before making payment to the PSC, remit the payments to HMRC on the PSC's behalf and report those payments via RTI. They are also responsible for making the Employer's NI payments. Essentially this means applying UK PAYE to the amount due to the PSC before making payment. The PSC is then paid the amount that is left over after income tax and Employee's NI has been deducted.

Where an agency supplies the PSC, the agency will rely on the assessment provided by the end client. If it is 'Inside IR35', the agency makes the deductions from the PSC for income tax and Employee's NI. The agency also makes the Employer's NI payment, recharging the end client accordingly.

The new IR35 rules will also take precedence over the current Construction Industry Scheme (CIS) rules (where the subcontractor is a PSC).

5. When do the new rules take effect?

On 6 April 2021.

By that date, you must have completed and communicated the IR35 assessments for all PSC contractors who are engaged by your business (whether directly or via an agency), including any who started their assignments before 6 April 2021 but are still delivering services past that date.

For any PSC contractors assessed to be 'Inside IR35', deductions for tax and NI must be made on any payments to the PSC after 6 April.

6. Who do the new rules apply to?

These changes will not affect small businesses.

For small businesses, the existing IR35 rules will continue to apply. We do not yet know exactly how 'small' will be defined, but we expect it will follow similar lines to the Companies Act definition: <https://www.legislation.gov.uk/ukpga/2006/46/section/382>.

All other private sector businesses will be affected by these changes, and all public sector bodies have been subject to these new IR35 rules since April 2017.

7. What can companies be doing now?

We already know the new rules will be broadly similar to the 2017 public sector changes. We also know that there is a lot to do to be ready for an April 2021 go-live. We therefore encourage you to take action now, rather than waiting for legislation to be released. These are our recommended first steps:

- A. Identify all your contractors.** Composing a definitive list of all your current contractors and how they are engaged, regardless of whether they are supplied via an agency, is the first step. Transparency will be key to success.
- B. Supply Chain Audit.** Ensure the audit covers all aspects of risk, not just PSCs. Engagers are already exposed to a number of liabilities – whether tax or rights focused – and this is the opportunity to put all your contractors and recruitment partners through appropriate checks.
- C. Undertake IR35 assessments on temporary roles.** You should conduct IR35 assessments on your critical roles first. The sooner you know the outcomes of these assessments, you quicker can communicate them. You may choose to use the free Check Employment Status for Tax (CEST) tool, or use in-house expertise, or use an external provider for the assessments.
- D. Decide how you will deal with contractors whose roles are deemed Inside IR35.** This may include implementing systems to deal with the tax and NI payments, looking at alternative contracting models, or moving contractors to other solutions (and how you will ensure the compliance of these solutions so you do not simply transfer your risk elsewhere).
- E. Ensure you have a trusted and supportive supply chain.** Whether that relates to direct contractors or the agencies you engage with, you will need to work much more closely with your recruitment supply chain in the future. Do you have the right partners in place? If not, start the process of refining your supply chain now. Do your agencies know about IR35? Have they been involved in the 2017 public sector changes? How much will they help you to comply with the new rules?

8. How can we help you?

- A. Experience** – Having managed the same changes for some large public sector clients, we’re very familiar with the new rules and the implications. We already have all the necessary systems and processes in place.
- B. Identifying Risks** – We offer comprehensive contractor audits that will consider all types of risks in your supply chain, not just IR35.
- C. Increasing Transparency** – We know exactly how all our contractors are engaged; we have no hidden intermediaries. We can provide that information to you quickly and efficiently.
- D. Specialist IR35 Support** – We recommend that our clients consider external consulting support and particularly the use of an external IR35 assessor. Two companies that we work with closely and would recommend are:

<p>Brookson Contact Name: Michael Howard Telephone: 01925 235736 Email: Michael.Howard@brookson.co.uk</p>	<p>Orange Genie Contact Name: Andrew Webster Telephone: 07827 810851 Email: Andrew.webster@orangegenie.com</p>
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- E. Flexible solutions** – We offer a range of contracting models. Where PSCs might not suitable for some businesses going forward, we have other compliant and cost-effective ways to engage contractors.
- F. Contractor Communications** - We know the importance of clear and timely communication in this talent-short landscape. We take full ownership of all contractor communications and management, including relaying assessment outcomes and making appropriate changes to assignments.

We are here to help. For more information on IR35, its potential impact on your business, and how we can help you identify, understand and mitigate your risks, please do not hesitate to contact us.