

## **IR35 – The changes and what it means**

The Government has now released the draft legislation for the extension of the off-payroll rules into the private sector. It has confirmed the following:

The off-payroll rules which currently apply in the public sector will also apply in the private sector from 6 April 2020.

The IR35 tests for whether an engagement is inside or outside IR35 are not changing. Rather who makes the status decision, and who makes deductions are changing.

The new rules will apply to payments made on or after 6 April 2020 (not just to assignments which start on or after that date).

There will be some changes to the existing off-payroll rules which will apply across the board.

End user clients which are small companies or organisations will be exempt from the changes. Public authorities, medium and large organisations with a turnover of more than £10.2 million per year will be within scope of the rules.

Affected clients will have to pass their status determination statement and the reasons for their determination to both the party they contract with and the off-payroll worker.

Liability will move down the supply chain until a party does not meet its obligations.

Clients will be expected to manage a process to deal with disagreements about tax status.

Clients which engage off-payroll workers / contractors (and their personal service companies) directly, will be the fee-payer for the purposes of the off-payroll rules.

### **A recap on the IR35 rules**

In brief the IR35 rules (set out in Chapter 8 of the Income Tax (Earnings and Pensions) Act 2003) (ITEPA) apply where an individual works through an intermediary, such as a personal services company, and provides their services to an end user client. They apply where:

- an individual has a material interest in the company they work through i.e. s/they own more than 5% of the company (so they do not apply for example, when an individual works through an umbrella company because s/he will not own shares in the umbrella); or
- in the case of a partnership s/he is entitled to 60% or more of the profits of the partnership or most of the profits of the partnership which come from one client or one client and its associates.

The IR35 rules provide that if that intermediary did not exist, but the individual looked like an employee of the client for tax purposes, then that assignment is deemed to be 'inside IR35' and the individual's pay should be subject to PAYE tax and national insurance. Employers' national insurance will also be due.

### **The off-payroll rules from April 2020**

Under the off-payroll rules: (a) the responsibility for assessing IR35 status moves from the intermediary to the end user client; and (b) when the engagement is inside IR35 the responsibility for making tax and national insurance deductions moves from the intermediary to the fee-payer (i.e. the party next to the intermediary in the supply chain, normally the recruitment agency). The off-payroll rules will apply to all payments made on or after 6 April 2020 and not just to assignments which start on or after that date.

### Small companies exemption

The off-payroll rules will not apply where the end user client is a small company, as defined in the Companies Act 2006. Group companies will not be exempt if the parent company of the group is not a small company. Similarly, in a joint venture if any of the JV partners are not small then the whole JV is not small.

### The IR35 status decision

Under the off-payroll rules the responsibility for making the IR35 status decision moves from the intermediary to the end user client. In the draft legislation this status decision is called the 'status determination statement' (SDS). The end user client will have to take reasonable care in making its status decision, otherwise it is not a valid SDS. Making a blanket decision that all off-payroll workers are inside IR35 or outside IR35 is not taking reasonable care. The draft legislation does not specify a tool that the client must use to reach its decision. What is 'reasonable' will depend on the resources of the client.

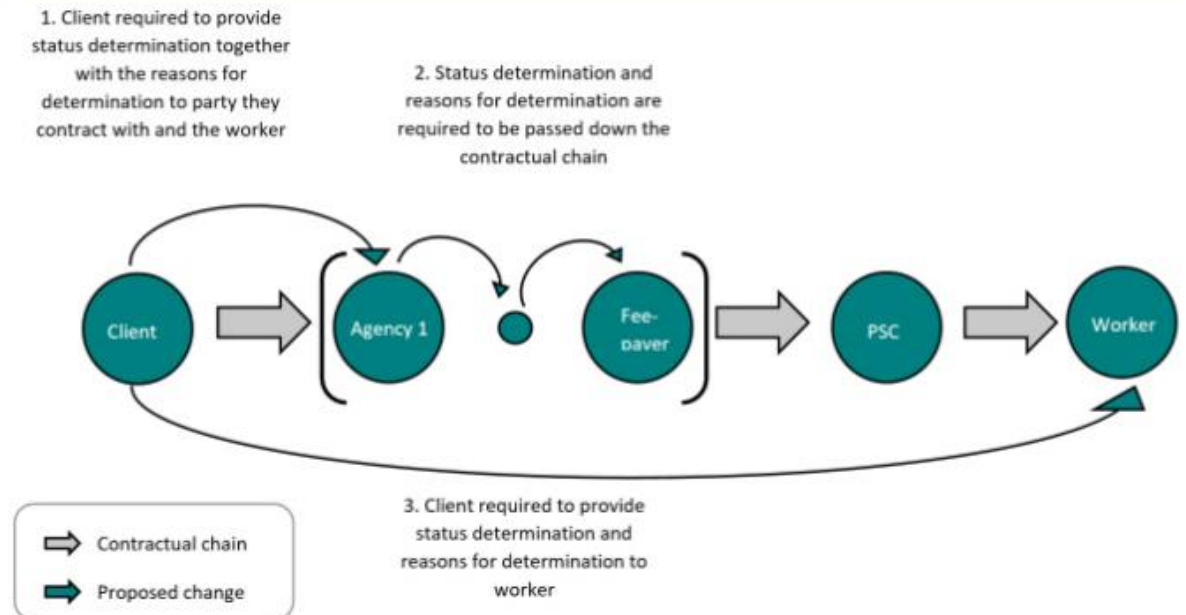
In 2017 the Government introduced the online Check your Employment Status for Tax (**CEST**) tool to assist the decision-making process.

**CEST** has come in for a lot of criticism – it cannot consider the nuances which a Tribunal can when looking at all of the evidence before it – and so the Government has committed to enhancing the tool. Alternatively clients can use any other tool or contract review service they wish but HMRC will not endorse any of these. Importantly, the IR35 rules themselves are not changing i.e. the tests which Tribunals apply when considering whether an engagement is inside or outside IR35. Who makes the status decision, and who makes deductions are changing.

### Passing status decisions through the supply chain

End user clients will have to assess the IR35 status of each assignment where the services are provided by an individual working through an intermediary. They will have to pass their status decision and their reasons for coming to that decision, to both the party they contract with and the off-payroll worker. In turn, each party will also have to pass the decision and the reasons for the decision to the next party in the supply chain.

## DIAGRAM: FLOW OF INFORMATION THROUGH THE LABOUR SUPPLY CHAIN



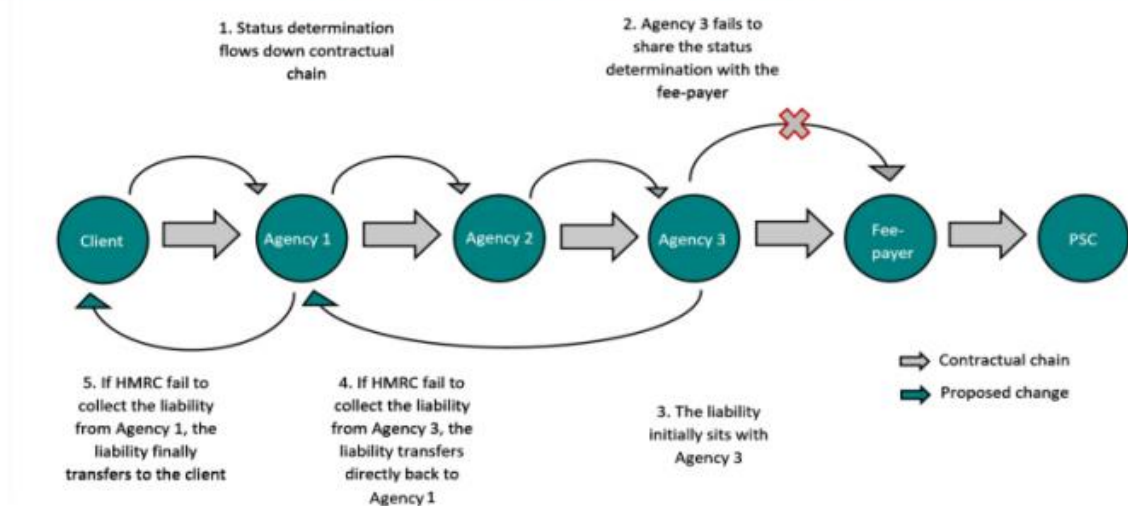
### Liability

There are a few different points to consider:

The fee-payer bears primary liability for applying the client's SDS and making the appropriate deductions;

- where the fee-payer is off-shore, the fee-payer's responsibilities move up the supply chain to the next UK based entity;
- liability will initially rest with the party that has failed to fulfil its obligations until such time as it does meet its obligations at which point liability moves down the chain. E.g. the client will be deemed to be the fee-payer until it passes the SDS to the next party in the chain and the off-payroll worker. As each party meets its information obligations, liability passes down the chain.
- However, if HMRC are unable to collect an outstanding tax liability from a party, then the liability for unpaid tax and national insurance will transfer back to the first agency in the chain, and if that fails, then HMRC will pursue the client. (See the diagram on the next page taken from the Government's Summary of Responses).
- A client will be deemed to be the fee-payer if it fails to withdraw an SDS where it becomes small and therefore exempt
- the client will also be deemed to be the fee-payer if it does not respond to representations about a status decision within 45 days of receiving those representations
- directors, office holders or associates of the fee-payer will not be personally liable for the fee-payer's failure to deduct tax or national insurance.

## DIAGRAM: TRANSFER OF LIABILITY ACROSS THE LABOUR SUPPLY CHAIN



### Resolving disagreements over status

The end user client will be required to set up a client-led status disagreement process to help resolve disagreements about the status decision reached. Either of the off-payroll worker or the deemed employer will be able to make representations to the client that its SDS is incorrect. The client must respond to those representations within 45 days as follows:

- (a) inform the off-payroll worker or the deemed employer that it has considered the representations and decided that its SDS is correct, and give the reasons for that decision; or
- (b) give a new SDS containing a different conclusion and state that the previous SDS is withdrawn. If the client does not respond within 45 days it will be deemed to be the fee-payer. We note that there are no limits on how many times the off-payroll worker or the deemed employer can make representations to the client. There is also nothing to say what should happen if the off-payroll worker or deemed employer still disagree with the client's status determination.

### Paying the off-payroll worker

When an engagement is inside IR35 the fee-payer must (a) calculate the 'deemed direct payment' due to the intermediary, and then (b) deduct PAYE tax and NICs from that payment.

It is likely that agencies and off-payroll workers alike will not wish to continue the use of an intermediary for an inside IR35 engagement as the perceived benefits of working through an intermediary are diminished (the accounting processes are also quite complex as you cannot payroll a company). In such cases, the agency can pay the off-payroll worker directly, and report through their own Real Time Information report. Alternatively they may wish to use an umbrella company to

pay the off-payroll worker. When using an umbrella the agency must be clear that the umbrella will pay the worker and manage all worker rights (traditional umbrellas will employ the worker and bear all employer obligations towards him/ her).

DEDUCTIONS AND REPORTING OBLIGATIONS BASED ON CLIENT'S DECISION:		
Client's status determination statement	Tax and NICs obligations	Reporting mechanism
The engagement is <b>inside IR35</b>	Fee-payer deducts tax and national insurance before paying the intermediary. Employers' national insurance also due.	Fee-payer must report this via Real Time Information.
The engagement is <b>outside IR35</b>	Fee-payer can pay intermediary gross. Intermediary is responsible for own tax affairs.	Fee-payer reports the gross payment via the quarterly ITEPA reports.

The Emerald group work closely with the Umbrella firm ICS ([www.icsuk.com](http://www.icsuk.com)) already and will continue to do so.

### Questions!

**Q: As a contractor what do I need to do?**

**A:** There isn't much you can do at the moment, other than keep speaking to your line manager if you are in contract about their plans/approach, and keep talking to well informed agencies who should be keeping on top of any recent developments. It is also prudent to speak to your accountant/tax adviser about possible impacts.

**Q: Which companies are doing what?**

**A:** Most companies are yet to confirm their approach. A handful (LBG, Pru, Barclays, HSBC) have confirmed that they will no longer engage contractors via PSCs although we have seen some instances to the contrary. A few others have confirmed they will be making individual assessments on each contract role.

**Q: Can I change the wording in my contracts to make sure I'm outside IR35?**

**A:** Basically, no! It is the actual working practices that are more important than the contract wording in determining IR35 status. Most reputable agents will have IR35 compliant contracts – it is how the contractor actually works that is the main determining factor.

**Q: Will HMRC look to backdate/go after historic cases?**

**A:** 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 Emerald Group continues to engage with both clients and contractors to help understand and manage any implications that may arise.

If you have any additional questions or would like to discuss in more detail please get in touch with our Head of Interim, Rob Gibson at [robert.gibson@emerald-group.com](mailto:robert.gibson@emerald-group.com) or 0203 8679858.