



# YOUR COMPLETE GUIDE TO THE UK'S MOST DISRUPTIVE CHANGE IN TAX LAW FOR EMPLOYERS



## IR35 REFORMS IN THE PRIVATE SECTOR



## Guide Overview:

In our latest guide, we explore the fundamentals of IR35, and the anticipated extending of IR35 reforms from the public sector, into the private sector.

We offer a recap of IR35 reforms in the public sector and its feedback, what we can expect from the introduction and how best to manage the reforms in the private sector, given that the Treasury decide to extend the reforms in the Autumn Budget 2018.

Included in this guide:

- **An introduction to IR35 in the private sector**
- **What is IR35?**
- **When do IR35 reforms come in for the private sector?**
- **Case Study: Christa Ackroyd vs HMRC**
- **Determining IR35 status**
- **Using HMRC's CEST Tool (Check Employment Status for Tax)**



## An Introduction to IR35 in the Private Sector

In essence, HMRC are planning to make changes to the UK tax rules in the private sector, specifically for off-payroll working (self-employed contractors), in the hope of minimising tax avoidance from 'disguised employees' working as independent contractors.

Currently, contractors determine their own IR35 status via their accountants or through independent worker status tests, however, the planned changes (which could be implemented as early as April 2019) will ultimately shift the liability to determine IR35 status from the contractors to the end user.

So, what will this mean for the end users and self-employed contractors operating in the private sector? Fundamentally, end users will be liable for any penalties or unpaid tax of their contractors if HMRC find that they have falsely labelled their contractors as outside of IR35, which sparks the fear that end users (to avoid risk) will gradually stop using contractors in the private sector.

It started with the public sector (In April 2017) – which reportedly caused a mass exodus of contractors out of the public sector. It is estimated that these changes could affect around 5.7 million private limited businesses and 2 million contractors in the UK.

A consultation on the plans was launched in May, and closed on 10 Aug 2018. In the consultation, HMRC estimated that just 10% of the Personal Service Companies (Limited Companies) that should apply the legislation actually do so.



## What is IR35?

IR35 is tax legislation that is designed to combat tax avoidance by workers supplying their services to clients via an intermediary, such as a limited company, but who would be classed as an employee if the intermediary was not used.

Such workers are called 'disguised employees' by Her Majesty's Revenue and Customs (HMRC).

The aim of the legislation is to eliminate the avoidance of tax and National Insurance Contributions (NICs) through the use of intermediaries, such as Personal Service Companies or Partnerships, in circumstances where an individual worker would otherwise:

- For tax purposes, be regarded as an employee of the client
- For NICs purposes, be regarded as employed in employed earner's employment by the client.



**HM Revenue  
& Customs**

Prior to the introduction of the legislation an individual could avoid:

- Being taxed as an employee on payments for services; and
- Paying Class 1 NIC by providing those services through an intermediary.



## What is IR35 cont.?

The worker/contractor could take the profits out of the intermediary, in the form of dividends instead of a salary, resulting in significant tax savings.

The legislation ensures that, if the relationship between the worker and the client would have been one of employment had it not been for an intermediary, the worker pays tax and NICs on a basis broadly equal to that an employee of the client would pay.

The legislation does not render a worker who is caught by IR35 entitled to employment rights (such as unfair dismissal and redundancy). IR35 only affects a worker's tax status.

Christian Verri, director at PwC, said that IR35 was introduced to stop tax avoidance and to tackle the disparity between the amount of tax paid by people providing their services through an intermediary and those who were employed directly by a company.

*The legislation does not render a worker who is caught by IR35 entitled to employment rights (such as unfair dismissal and redundancy). IR35 only affects a worker's tax status.*





## What exactly is IR35 cont.?

If a worker/contractor provides their services through a limited company, they are free to withdraw their income through more tax-efficient forms – as opposed to a salary that would be taxed under PAYE and subject to NICs.

Verri explained that the current regulations, introduced in April 2017, tackled widespread non-compliance with the IR35.

*"Under the old regulations, the contractor or worker had to determine if they fell under the IR35, and research estimated that only one in 10 people were using the IR35 correctly. Rules weren't followed," Verri said. "HMRC did not have the resources to enforce regulation across all users.*

*The new regulations meant that the end user had to determine if the worker's role could come under the IR35 and if the withholding has to apply. As such, the public sector body has to operate that holding. The new IR35 regulations were designed to increase compliance and increase taxes."*

Verri said the new IR35 regulations have also increased 'fairness' in the economy.





## When do IR35 reforms come in for the private sector?

The IR35 reforms that have already been in force in the public sector look likely to hit the private sector as early as April 2019. Whilst an actual date is yet to be confirmed, we can expect to hear some answers regarding IR35 reforms in the private sector in the Autumn Budget 2018 on Monday, 29th October.

Following the introduction of the public sector reforms, research was conducted by Harvey Nash, a management consulting company, on contractors' thoughts and impact of the new legislation. The results were "very negative", with over 450 of the 500 contractors (90%) polled stating they were "stressed, worried or angry" and over half (51%) said they'd seen a downturn in available contacts.

Nearly half (49%) said they now only seek contract opportunities in the private sector. Additionally, 42% of contractors reported that they increased their rates to balance the cost of 'being caught within IR35', compared to 16% who said the same last year.

Harvey Nash said the results suggested a "huge increase in contractors upping their fees to counter the knock to their incomes".

## **Case Study (BBC North Presenter, Christa Ackroyd vs HMRC - False Self-Employment)**

In February, former BBC Look North presenter Christa Ackroyd faced an unpaid tax bill of £420,000 after a tribunal ruled that she paid too little tax. Ackroyd said she was one of a number of BBC presenters and staff who were employed by the BBC through a limited company.

The tribunal did not criticise Ackroyd for not realising that the IR35 legislation was engaged.

"She took professional advice in relation to the contractual arrangements with the BBC, and she was encouraged by the BBC to contract through a personal service company," it concluded.

The High Court found that Ackroyd had not been working as a contractor but rather was effectively employed by the BBC. The judge said Ackroyd was "inevitably seen as a part of the BBC... an external observer would not know the details of the hypothetical contract".

A month after Ackroyd's ruling, a Department for Digital, Culture, Media and Sport session examined witnesses who gave evidence that hundreds of BBC presenters and staff were 'coerced' into forming PSCs to gain work at the organisation, so it could treat them as freelancers for tax purposes.

Andrew Chamberlain, deputy director of policy and external affairs at freelancers' body IPSE, said: "By allegedly being coerced into these contracts, these individuals may have been denied employment rights, and some face liability for huge tax bills.

"The evidence presented gives a distressing insight into the effect the protracted discussions on pay have had on staff and their families. Some have faced working without contracts and pay for extended periods, causing untold stress and financial insecurity.

"This evidence indicates that the BBC is falling well below the standards we would expect in terms of how it treats its staff. It is disappointing that BBC management are not coming in person to answer questions on their handling of these contracts."



## Determining your IR35 Status

Determining whether a person works under a contract OF service (employment) or FOR services (self-employed, independent contractor) is key when it comes to applying the tax benefits of self-employment.

The fact is that for tax and NICs purposes, there is no statutory definition of either type of employment status, which is why there's so much speculation about IR35 not being 'black or white'.

In order to determine the nature of employment status, it is necessary to apply the relevant factors and tests the courts have, over the years, laid down. These have led to a series of questions that provide a general guide as to whether a worker is an employee or self-employed.

If the majority of answers to the following questions is 'Yes', the more likely an individual is to **fall inside IR35 and therefore a 'disguised employee' of the end client:**

- Do they have to do the work themselves?
- Do they have to work a set amount of hours?
- Can someone move them from task to task?
- Are they paid by the hour, week, or month?
- Can they get overtime pay or bonus payment?
- Can someone tell them at any time what to do, where to carry out the work or when and how to do the work?





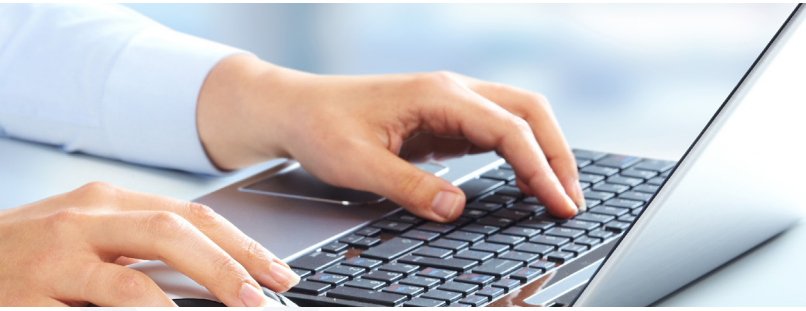
## Determining your IR35 Status cont.

If the majority of answers to the following questions is 'Yes', the more likely an individual is to **fall outside IR35 and be genuinely self-employed**:

- Can they hire someone to do the work or engage helpers at their own expense?
- Do they risk their own money?
- Do they provide the main items of equipment they need to do their job, not just the small tools that many employees provide for themselves?
- Can they decide what work to do, how and when to do the work and where to provide the services?
- Do they agree to do a job for a fixed price regardless of how long the job may take?
- Do they regularly work for a number of different people?
- Do they have to correct unsatisfactory work in their own time and at their own expense?

The best way to deal with IR35 is not to be in a position where you have to prove you are not a 'disguised employee' but to ensure your practices are in line with the criteria for being self-employed.

Ultimately whether you fall inside IR35 on a particular assignment is determined by the specific facts of each situation and each assignment you undertake will be considered on its own merits based on all of the relevant case law precedents.



## Using HMRC's CEST Tool (Check Employment Status for Tax)

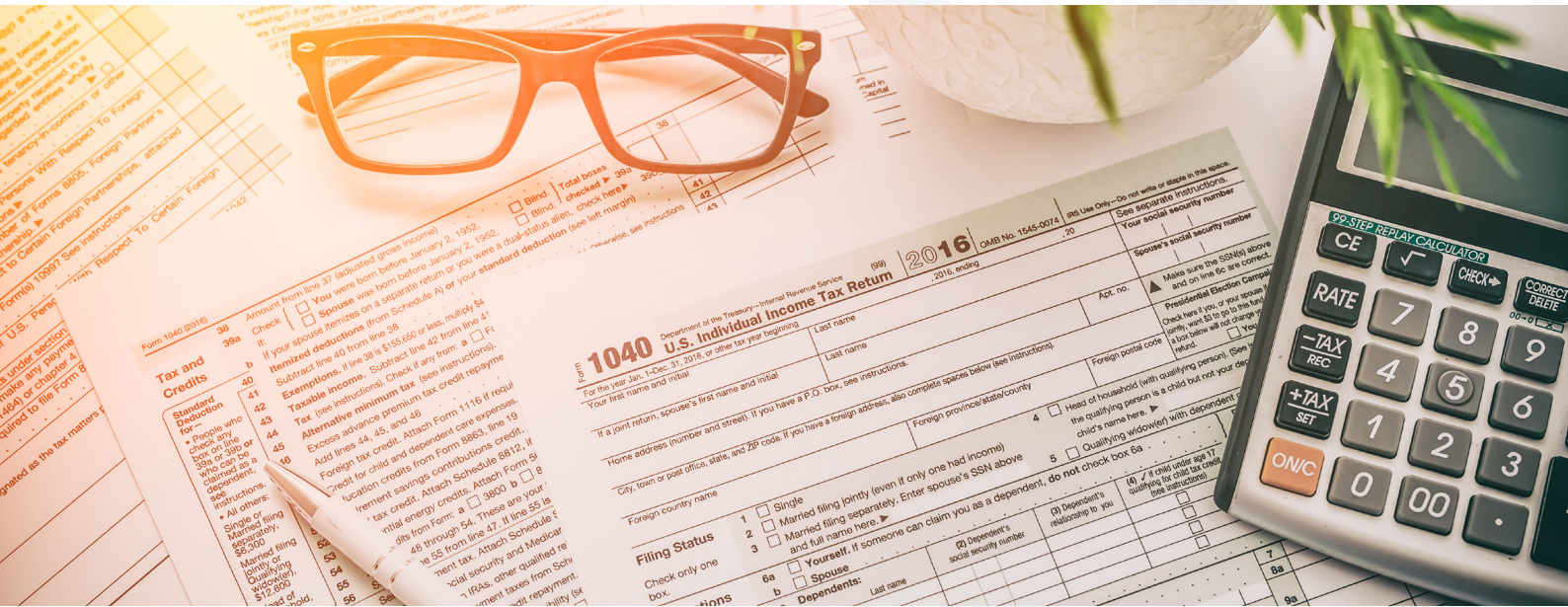
Whilst it's not compulsory to use, HMRC's CEST tool provides an opportunity for contractors to determine their IR35 status by answering a selection of questions which relate to their assignment of work.

Although the government tool has been used by many UK contractors, it has also received some negative feedback from participants, labelling the tool as "not fit for purpose", "biased" and "hopelessly unreliable".

The problem that persists, according to contractors, is the lack of depth of the tool. When conducting an inquiry, a HMRC inspector will typically ask at least 50 questions of a contractor, and often in excess of 100. CEST only asks a minimum of 16 questions, and may even return a status assessment based on answers provided to just four questions.

If the Treasury choose to extend the IR35 reforms to the private sector, we can only expect HMRC to push employers to use its CEST tool, which, according to the feedback of multiple contractors in the UK, is biased towards falling inside of IR35.

This being said, HMRC have recently stated that they're always looking at ways they can improve the CEST tool and, when we find out if and when the reforms extend to the private sector, HMRC will look to develop the tool further for employers use.



## Summary

With the IR35 consultation now closed, contractors and the UK's 5.7m private sector businesses are anxiously waiting to hear the government's next move with regards to reform, at the Autumn Budget on Monday, 29th October.

Should the Treasury decide to extend the changes against the best advice of IR35 experts, it is likely that any business engaging a freelancer or contractor will be handed the responsibility of setting the status of the individual.

As if that isn't a big enough burden, these businesses will also carry the liability should HMRC investigate and deem the decision wrong.

IR35 liability can run into hundreds of thousands of pounds and, given contractors are now a vital resource for businesses of all sizes, these engagers must equip themselves with the skills needed to make accurate IR35 decisions on what would be a huge scale.

The fact the government has regularly alluded to the possibility of private sector changes following the public sector rollout makes further reform seem somewhat inevitable.



## So, how can HR teams and recruitment agencies manage IR35 reform?

First, it is manageable, contrary to speculation, but preparation should start sooner rather than later. And simply, mistakes made in the public sector cannot be made this time around.

Businesses must avoid making blanket decisions and can't place their entire contractor workforce inside IR35 in an attempt to protect their own liability.

This risk-averse approach will simply deter contractors and lead to further non-compliance. Just look at the NHS – it placed all temporary staff and contractors inside IR35 without a fair assessment, and 98 per cent of these independent healthcare professionals are considering seeking work elsewhere as a result.

When it comes to setting status, businesses should bear in mind that CEST – HMRC's much-maligned IR35 tool – is not mandatory and independent assessments are perfectly acceptable.

As explained previously, the technology has been criticised for its one-size-fits-all logic and failure to examine the unique details of a working arrangement.

In addition to this, 81% of contractors surveyed by Harvy Nash, said they would be discouraged from working with a client or through an agency should CEST be the sole way of assessing IR35.



## **So, how can HR teams and recruitment agencies manage IR35 reform cont.?**

Contractors have clear concerns over engagers' ability to make well-informed status decisions, which is why businesses would be wise to offer them reassurance. Should these organisations want to retain contractors, and agencies hope to continue placing them, communication with contractors has to start now.

By letting contractors know that your organisation is proactive and will make accurate IR35 decisions a priority, these widely expected changes will be less disruptive. In short, contractors will have no qualms about working with businesses that give them a fair shot at working outside IR35.

As you might well know, IR35 is complicated. It is the legislation's complexity which can often lead to incorrect decisions. It remains to be seen whether the government will listen to calls to prohibit private sector reform, but we might learn more in the budget on Monday, October 29. That said, all the signs point towards a rollout of private sector reform in due course, which simply emphasises the need for businesses to begin preparations.