IR35:
THE STORY SO FAR

April 2019
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Introduction

Originating in 2000, the off-payroll working rules, often referred to as IR35 rules, are not a new but have gained significant traction in recent years following a change in the operation of the rules within the public sector in April 2017 and the proposed private sector introduction in 2020.

Many of the teething issues from the public sector implementation should (hopefully) improve the process when it comes to the private sector. Bearing in mind this isn't brand new legislation - it has been around for more than 18 years - the legislation now seeks to shift responsibility for determining the status of the worker to the end user together with liability to operate PAYE and NIC.

As a leading UK provider of engineering contingent recruitment we have observed first-hand the impact of IR35 reform on candidates and customers.

This paper has been created to share our insight, knowledge, experiences and opinions. It provides historic events, future outlooks and some practical tools to aid workforce assessment. The reforms to IR35 do not need to be a daunting prospect, let us guide you through it.

This publication provides information on legal issues and developments of interest to our colleagues, clients and friends. The material is not a comprehensive treatment of the subject matter covered and is not intended to provide legal advice. Readers should seek specific legal advice before taking any action with respect to the matters discussed in this publication.
IR35 timeline

2000
IR35 introduced

2012
Off-payroll assurances for those earning £220/day in the public sector

2015
Budget
Government announced proposed reform of IR35

July 2015
HMRC document published setting out rationale and options for reform

December 2016
Draft legislation published

2016 autumn statement
Government started consultation and confirmed need for reform

2016 Budget
HMRC consultation regarding off-payroll working in the public sector published

May 2016
Government confirmed intended reforms of IR35 but only in public sector

April 2017
New rules take effect in public sector

November 2017
Consultation announced for private sector

May 2018
Consultation on private sector changes released

2018 autumn statement
Announced reforms to IR35 will be rolled out to private sector in April 2020

April 2020
Roll out date for the private sector

Summer 2019
Draft finance bill expected to be published with more guidelines

March – October 2019
Planned exit from the EU
What is IR35?
IR35 (often known as ‘off-payroll rules’ or ‘intermediaries legislation’) seeks to ensure that people working via a personal service company (“PSC”), and who would have been employees if they had been engaged directly, pay broadly the same amount of Income Tax (“PAYE”) and National Insurance Contributions (“NICs”) as if they were employed.¹

HMRC estimates that currently only around 10% of people who should comply with the IR35 rules do so. The cost of non-compliance in the private sector alone estimated to reach £1.2 billion a year by 2022/23.²

How it began
The off-payroll working rules have been around since 2000, they are aimed at cracking down on tax avoidance from ‘disguised employees’. Under the current IR35 rules in the private sector, it is the responsibility of the PSC to determine whether an individual falls within the scope of the IR35 rules and therefore the obligation to operate PAYE and NIC where necessary.

Public sector reform
In April 2017, HMRC introduced reforms to the IR35 rules in the public sector which meant the onus for determining whether a role should be deemed as inside or outside of the scope of IR35 fell to the end user (i.e. the public sector body), not the PSC as it had been the case previously. Further the obligation to operate PAYE and NICs rests with the public sector bodies and their suppliers, leaving them open to potentially heavy penalties for failing to comply.

The IR35 reforms also had a potential consequence of bringing contractors, who previously were outside of the Agency Workers Regulations 2010 (“AWR”), within the regulations which include, amongst others, the right to access the end user facilities from day 1 (such as parking and staff canteen) and parity of pay and working conditions with the end users own employees.

How did contractors respond?
Contractors responded differently to the changes, but it essentially came down to three scenarios:

Contractor bore the cost of Employers NI (and PAYE and NICs) by way of reduced pay rates;
The client (end user) took the additional cost by accepting an increased rate in order to make up the take-home pay of the contractor;
Contractor declined new contract and left public sector.
The results
In its launch of the private sector consultation HMRC indicated they believed the implementation of the changes to the public sector IR35 rules were a success. There are some that disagree with this citing loss of talent to the private sector, higher cost, and project delays as some of the reasons to why the changes were not successful for all those impacted.

According to research by the CIPD, 51% of public sector hiring managers had lost skilled contractors as a direct result of the changes to IR35 regulations and 52% had witnessed cost rises, delays and project cancellations.³

Private sector next
As previously mentioned, HMRC have reported that the costs of non-compliance in the private sector is growing from £700 million in 2017/18 to a predicted £1.2 billion a year by 2022/23.⁴

In the Autumn Budget 2018 the government announced its intention to make changes to the IR35 rules applicable to the private sector, similar to those made in the public sector in 2017. The changes to the rules will be effective from April 2020 although will only apply to medium and large sized businesses / end-users (definition of which is yet to be determined).⁵

What does the reform mean for businesses?
From the 6 April 2020, medium and large businesses will need to determine whether the contractors they engage will fall inside or outside IR35 rules. If it’s deemed that IR35 rules do apply, then the business, recruitment agency or umbrella company which pay the worker’s company will need to deduct PAYE and employee NICs and pay employer’s NICs.
In or out?

Whether a contractor is deemed to fall inside or outside of the scope of IR35 rules will depend upon a range of factors; there are a number of tests to look at and the determination is by no means straightforward. The following are often seen to be the key tests:

1) **Supervision, direction, and control**: What degree of supervision, direction and control will you have over what, how, when and where the workers complete their contract and day to day work?

2) **Personal service / substitution**: Are they required to carry out the work themselves, or can they send someone in their place?

3) **Mutuality of obligation**: Are you obliged to offer them work and are they obliged to accept it?

These principles will be the same in both the private and public sector. End users will need to carry out an assessment of their contractor population to determine whether workers fall inside or outside of the IR35 rules.

The following two examples from HMRC show how individual roles may be assessed under the IR35 status test:

<table>
<thead>
<tr>
<th>Scenario 1</th>
<th>Scenario 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Description</strong></td>
<td>An engineering company takes on Luke to design a new bespoke drilling machine. Luke and the company agree a price for the job and a date when he will complete the work. Luke works from home most of the time and uses his own equipment. He’s free to work for other clients but faces a contractual penalty if he doesn’t deliver the machine on time, to the agreed standard. This represents a significant financial risk to Luke if he fails to deliver the final product as agreed.</td>
</tr>
<tr>
<td><strong>Verdict</strong></td>
<td>Likely to be outside scope of IR35</td>
</tr>
</tbody>
</table>
How will it affect you as a private sector employer?

The level of impact from the reform to the IR35 rules will differ from business to business depending upon the contractor population, i.e. numbers and what work they are undertaking.

Each business needs to take steps now to determine the level of impact; however experience from the public sector changes suggest the following may happen:

<table>
<thead>
<tr>
<th>Increased skills shortages</th>
<th>Contractor talent decide to leave the company because it’s no longer as lucrative, leaving holes in the talent pool and reducing the quality of workers.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increased costs</td>
<td>To keep existing contractors you may be forced to pay them more to cancel out the extra tax they now have to pay. These increased costs can add up over time and cause projects to go over budget.</td>
</tr>
<tr>
<td>Delayed projects</td>
<td>Departing contractors and/or delays in responding to IR35 could then cause delays and disruption to your existing projects.</td>
</tr>
<tr>
<td>AWR</td>
<td>Risk of employment rights claims through Agency Worker Regulations or Employment Appeals Tribunal</td>
</tr>
</tbody>
</table>

The Future for PSCs?

Previously, when it was targeted at the public sector, any contractors who fell within IR35 rules had the choice to either: (a) stay in their current contract but pay PAYE and NICs; (b) negotiate a higher pay rate to offset the lower take home pay; or (c) to leave the public sector and get work in the private sector. Once the further IR35 reforms are introduced the same IR35 rules will apply to both public and private sector workers.

Brexit

With the ongoing uncertainties about the impact of Brexit (in particular the when and how the deal might look) there is still no known impact on the IR35 reform at present. However some of the Brexit-related concerns such as lack of overseas talent might be exacerbated by IR35 as the number of candidates from the EU is already dwindling.
Still work to do?

Although there is plenty of information online about what the private sector reforms will entail, the government is expected to announce a further consultation in the first quarter 2019 into how the rules will look, with draft legislation anticipated to be published in summer 2019 as part of the Finance Bill legislation.
How to prepare

Whilst there is some breathing space between now and April 2020, business should start to consider how they will be impacted and plan how to deal with the reform.

Bear in mind the IR35 rules will not just apply to new workers, but also to existing workers as of April 2020. Analysing your existing workforce can help you to determine your level of risk, and put in motion mitigating steps.

We have come up with a few different methods to help you be more organised. Firstly, you need to assess the current assignments and workers for IR35 status by using one of the various options available to you:

1. Map the operating structures

Create a document that details all current contractors and how they are currently being paid. Ask your suppliers to help you to categorise how your existing contractors are being paid. This will then allow you to prioritise where to focus your actions and understand the impact of any potential changes.

We have created a form to make this easier which can be downloaded for free here.

Whatever method you use, you need to understand the operating structures used by existing contractors, which will fall under the following:

- PSC;
- Umbrella company;
- Self-employed;
- Agency PAYE;
- Other.

This analysis will enable you to review your contractor population and identify areas of risk or concern.
2. Coupled with the above form, use HMRC’s online tool to ascertain a contractor’s IR35 status for any roles where PSCs are working:

The tool to help businesses determine whether the IR35 rules apply can be viewed on the government’s Check Employment Status for Tax (CEST) service. The service can be used for current or future engagements in the private or public sector. This will enable either the worker, the end user or the agency to assess the status of the role.

HMRC will stand by the result given unless a compliance check finds the information supplied is inaccurate.

The CEST tool can be viewed here.

3. Engage a specialist company to advise

There are a number of companies that specialise in IR35 legislation, which can offer advice and guidance on navigating the choppy waters of the IR35 rule. However, as always we would recommend caution in using these third party organisations – anyone who says they have the “solution” to the IR35 reform should be treated with scepticism.
Next steps

Once you’ve got a strong understanding of how your contract workforce is set up and you’ve organised them into inside/outside of the IR35 rules, we would recommend the next steps:

**Transparency**

Speak to your contractors and discuss their IR35 status and what their options are. Be open and honest and discuss with your recruitment partners who can be valuable resources to help educate hiring manager’s behaviour around their use of contractors, and conveying opportunities to candidates who may be less informed on IR35 rules, ensuring better access to talent.

**Training**

Engage a specialist to provide company-wide training to educate on IR35 changes. This will ensure that any training is accurate and up-to-date, mitigating any risk to processes.

**Tactics**

IR35 implementation may drive existing workers away from contacting and into early retirement, permanent roles or smaller businesses. For some businesses, using a different talent-sourcing model such as Statement of Work may be a viable option. Alternatively, the Managed Service Provider (“MSP”) model could offer some comfort when it comes to properly qualifying roles and locating talent in tough markets at reasonable cost.
Conclusion

So yes, IR35 is not new, but the way it has been applied in the public sector and will soon be applied in the private sector is. It’s likely to have a significant impact on a number of operating PSCs and organisations that benefit from their services. However, as with the public sector, it will soon become the new norm across the UK. It’s not yet clear how this will impact on the form of engagement of thousands of PSC contractors but it is an adjustment our industries must make. In doing so, throughout the supply chain, we must be conscious of the impact changes have on businesses and especially on people.

Preparation is key and we have provided some tools to support this.

As a leading engineering recruitment business, we have witnessed other legislative changes over recent years and played a key role in supporting change with both candidate and customer.

If you need any additional advice about IR35 or other employment related issues, please don’t hesitate to contact us for further information.

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Email: offpayroll@carbon60global.com

1. IR35: Estimating the administrative burden
2. FACTSHEET: Consultation on off-payroll working in the private sector
3. Off-payroll working in the private sector - CIPD
4. Off-payroll working in the private sector – Consultation outcome
5. Off-payroll working in the private sector (IR35): Budget 2018 brief
6. Off Payroll Working in the Public Sector Appendix A