



Carbon60

IR35 in the Private Sector How to prepare for April 2020



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Introduction

The off-payroll working rules, often referred to as IR35, are not new but have gained significant traction in recent years as HMRC focusses on tackling tax avoidance.

Originating in 2000 the reforms started first in the public sector in April 2017, with the proposed private sector introduction coming in April 2020.

As a leading recruitment and service provider we have observed first-hand the impact of IR35 reform on candidates and customers. Many of the teething issues from the public sector implementation should (hopefully) improve the process when it comes to the private sector.

This paper has been created to share our insight, knowledge, experiences and opinions. It provides historic events, outlooks and some practical tools to aid workforce assessment.

There is a lot of jargon involved in this reform, but it doesn't need to be a daunting prospect; check out our Glossary of Terms and follow our five simple stages of preparing your business for this reform.

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.



History

What is IR35?

IR35 received its name because it was the 35th press release issued by the Inland Revenue, now called HMRC. However, it is often referred to by the more descriptive name of 'off-payroll rules' or 'intermediaries legislation'.

Put simply IR35 is a tax law aimed at cracking down on tax avoidance.

This legislation effectively seeks to ensure that individuals are not operating as 'disguised employees'. This is broadly defined by HMRC's as people working via a personal service company ("PSC"), who would have been employees, if they had been engaged directly, and therefore pay broadly the same amount of Income Tax ("PAYE") and National Insurance Contributions ("NICs") as if they were employed.

Why is it changing?

The original legislation placed the responsibility on the PSC to determine whether an individual fell within the scope of the IR35 rules, and therefore the obligation to operate PAYE and make NIC where necessary.

In practice this meant that individuals could make an incorrect assessment, and due to the difficulty in enforcing, it went unnoticed. The HMRC estimated that currently up to 90% of those working through PSC's are operating

under 'incorrect determinations' which would not comply to IR35.

This comes with an estimated cost of non-compliance. In the private sector alone, this is estimated to reach £1.2 billion a year by 2022/23, which is undoubtedly driving these reforms.

In or out?

When referring to IR35 you will commonly hear the terms in / inside or out /outside which mean;

Inside IR35; PSC workers are considered as an employee, for tax purposes only, and subject to full PAYE and NIC.

Outside IR35; PSC is operating as a genuine business and therefore outside of the off-payroll working rules.

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.

Assessment of whether a role is inside or outside is not simple, and HMRC have recommended using the CEST tool to work out the status for each.

However, you can also use the following basic key tests to see if a role would be at risk of being inside:

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?

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

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

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

Outside IR35

- 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 they will complete the work.
- Luke works from home most of the time and uses their personal equipment.
- They are free to work for other clients but faces a contractual penalty if they don't deliver the machine on time, to the agreed standard.
- This represents a significant financial risk to Luke if they fail to deliver the final product as agreed.

Inside IR35

- The same engineering company needs someone to maintain the new machine.
- The hire Lee to work three days a week, eight hours a day.
- Lee is provided with a laptop and the tools so they can work at the office or at home with their prior permission.
- They report into the Manufacturing Manger and must ensure the machine is running at full capacity to the required company standards.
- The company is responsible to provide the correct safety equipment Lee needs to do the work.
- If Lee needs to work longer than their contracted hours they will get overtime.

Public sector reform

In April 2017, HMRC introduced reforms to the public sector. The key factor was 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 had been the case previously.

Furthermore, the obligation to operate PAYE and NICs rests with the fee-payer, be that the public sector bodies or the recruitment provider, leaving them open to potentially heavy penalties for failing to comply.

Lessons learnt

HMRC indicated they believed the implementation of the changes to the public sector IR35 was a success. Yet there are some that may disagree with this.

Some public sector bodies would cite loss of talent to the private sector, higher cost and project delays as some of the reasons why the changes were not as successful as might be suggested. Research by the CIPD suggested that 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.



Private sector next

In the Autumn Budget 2018, the government announced its intention to make changes to the IR35 rules applicable to the private sector. With the reported costs of non-compliance in the private sector growing from £700 million in 2017/18 to a predicted £1.2 billion a year by 2022/23, it is clear why this might be.

The changes to the rules will be effective from April 2020, although will only apply to medium and large sized businesses / end-users.

No impact for small companies

A business is deemed to be a 'small' company if it meets 2 or more of the following criteria within a 12-month period:

- Turnover not more than £10.2 million
- Balance sheet total not more than £5.1 million
- Under 50 employees

If you are a small company you don't yet need to abide by these rules. However, if you are working with a recruitment partner, they may request you provide a written declaration of this to keep on file.

What does the reform mean for medium and large businesses?

From the 6th 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 fee payer will need to deduct PAYE and employee NICs and pay employer's NICs.

Key changes

We have learnt a lot about this reform from the public sector changes in 2017, however there are a few more key changes that have been announced.

Status Determination Statement ("SDS")

The end user is responsible for making the determination and are required to provide an explanation as to how they reached that decision. Further, the client is required to notify both the PSC and the Fee Payer.

It is important to note that where the client has failed to provide an SDS it is deemed to be the Fee Payer assuming tax risk.

Blanket assessments

Blanket assessments, which were commonly used in the public sector, resulted in contractors being deemed employees for tax purposes automatically.

Although undoubtedly less complicated to implement to business, HMRC have stated

that blanket assessments are not compliant and that each role will require individual determinations to be made.

To ensure blanket assessments don't take place HMRC have also indicated that "reasonable care" must be taken with assessments.

Statutory disagreement process

In some circumstances the worker or Fee Payer may disagree with the clients SDS, either the full circumstances have not been considered or there is a belief that the client has not taken reasonable care in reaching the determination.

The government are introducing a statutory, client-led status disagreement process to allow workers and fee payers to challenge the determinations. It has stipulated that the client will have 45 days to respond to a disputed SDS.



How will this affect you?

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.

As we learn from the pain of the public sector report, preparation is key and businesses must take steps now to determine the level of impact. Failing to do so could result in:

Increased skills shortages	Contractor talent decides to leave the company, leaving holes in the talent pool and reducing the quality of workers.
Increased costs	To retain existing critical contractors, you may need to pay increased rates in order to maintain their levels of take-home pay. These increased costs can add up over time and cause projects to go over budget.
Delayed projects	Departing contractors and/or delays in responding to IR35 could then cause delays and disruption to your existing projects.

The future of 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 requiring significant additional administration and paperwork
- b) negotiate a higher pay rate to offset the lower take home pay via a PAYE model
- c) to leave the public sector and get work in the private sector to retain the way they were previously working.

Once the further IR35 reforms are introduced, the same IR35 rules will apply to both public and private sector workers which will likely result in a much lower number of PSCs that are determined outside of IR35.

How to prepare

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.

To keep this simple, we have broken it down into 5 stages to help you prepare.

Stage 1: Map the operating structures

Create a document that details all current contractors and how they are currently being paid. This will require you to speak to your directly engaged contract workforce or ask your recruitment supply chain to provide this.

This will then allow you to prioritise where to focus your actions and understand the impact of any potential changes. Operating structures could include:

Contractor type	Risk
All PSC's	High Risk
Umbrella PAYE	No Risk
Direct PAYE	No Risk
Agency PAYE	No risk
Other*	High Risk

This needs only to apply to those who will be working on contracts in April 2020. Make sure you also consider any possible contract extensions. This analysis will enable you to review your contractor population and identify areas of risk or concern.

Stage 2: Use CEST tool to work our status of high-risk roles.

Use HMRC's online tool, Check Employment Status for Tax (CEST) service, to ascertain all roles where you have high risk contractors working IR35 status.

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](#).

Stage 3: Create policies & procedures

Set the policies on how you will engage with contractors that you have identified as in scope for IR35. Consider:

- a) Will you continue to engage PSCs who are found to be in scope of IR35?
- b) Ensure that recruitment partners have robust procedures in place to ensure the compliance of Umbrella companies.
- c) Provide an SDS for all roles, regardless of status or operating structure.
- d) Agree a process for carrying out assessments and completing the SDS. Identify those responsible for completing such tasks.

Stage 4: Communicate your actions

Speak to your directly engaged contactors and discuss their IR35 status and what their options are.

Our team at Carbon60 are available to help educate hiring managers' behaviour around their use of contractors, and conveying opportunities to candidates who may be less informed on IR35 rules, ensuring better access to talent.

Stage 5: New hires process

Once you have procedures in place for your existing workforce you may wish to consider how you would implement this for new hires from 2020.

Areas you can consider include:

- establish a baseline assessment based on a role
- provide recruitment partners with an indication of status when releasing a job role
- complete proper assessment prior to commencement of an assignment
- issue SDS prior to commencement of an assignment



Could Statement of Work be the answer to IR35?

IR35 is a big talking point in businesses right now and with the private sector roll-out coming to medium and large businesses in April 2020, many businesses are looking for an answer to the complexities this will bring.

Due to its complexity, there is no one-size-fits-all solution. However, by changing our thinking around how we manage contract workforces this can be an opportunity to not just mitigate tax risks, but to actually improve the efficiencies of our workforce.

Statement of work

Statement of work is how we structure outcome-based work solutions. Many projects are currently run on a time and material (T&M) basis.

For example, if you needed to upgrade a piece of software across your business, you would likely need to advertise, interview and hire a team of engineers and induct them into your business ready to deliver the upgrade. This team would likely be paid on expensive day rates, require day-to-day instruction and management, and be required to attend company meetings. All of these factors (among many others) would bring them inside IR35, as well as being time consuming to manage and having no guarantee of delivery.

However, under an outcome-based statement of work you can mitigate some of the risk factors of this scenario. Run as a

fixed-price project, you would not need to manage each individual contractor to turn up each day and complete task X by Monday. Instead, you would focus on them delivering the software upgrade by the agreed date. You wouldn't need to hire the team or worry about authorising time sheets, but instead sign off work completed, saving a considerable amount of time and administration, as well as mitigate many of the risks of IR35 compliance.

This way of working is already common across IT projects and we have extensive experience working in this way with some of our key Aviation, Defence and Engineering clients too. Yet the benefits of this model can easily be extrapolated to a business in any sector.

Shift away from man-management and drive efficiencies

If you change to this way of thinking you make sure your workforce is IR35 compliant, and this outcome-based way of working improves efficiency and productivity too.

Effectively, contractors who are paid a day rate really benefit when work runs late and the reality is you are unlikely to have the technical capability to effectively manage them. But by switching to an outcome-based model you can incentivise individuals based on delivering high-quality work on time.

Ultimately it is about shifting our thinking from this man-management to working with a service provider and measuring deliverables, even if it is a one-man-band limited company. This service provider can then bill the business at agreed milestones and/or on project completion.

What about IR35?

With IR35 coming into place, the traditional T&M resource model also comes with the administration of working out which roles fall in or outside of IR35 and, if they do come within, the additional costs of PAYE and NIC on top.

With the lack of clarity, the risk would be that the individual contractors will receive reduced day rates as well, resulting in a loss of talent for your business, further impacting on productivity.

If you can focus instead on “What outcome do I want” and enlist a service provider to work backwards from there, you mitigate these risks as well as driving more productivity into these projects.

IR35, in our opinion, doesn't need to be something to be scared of. It can actually be a catalyst for changing the way we think about workforce management to a more statement of work-based way of thinking. Smart business leaders will realise the benefits of this far outstrip IR35 compliance.

Find out more

Want to know more about how statement of work could work for your business?

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Glossary of terms

CEST

Checking Employment Status for Tax (HMRCs' Online Tool)

Client

Organisation for whom the services are being performed

Fee Payer

Entity paying the PSC (could be a recruitment agency or client)

Inside IR35

PSC workers are considered as an employee, for tax purposes only, and subject to full PAYE and NIC.

NIC

National insurance contributions

PAYE

Pay as you earn

Outside IR35

PSC is operating as a genuine business and therefore outside of the off-payroll working rules.

PSC

Personal Services Company also known as Limited Company Contractor

SDS

Status Determination Statement

Next steps

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 our people.

Despite this we feel it is an opportunity for us to revisit old hat contractor management, and drive efficiencies.

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.

About Carbon60

Connecting Talent, Improving Business

Carbon60 is a specialist technical recruitment consultancy and service provider.

Working across Aviation, Construction & Property, Civils & Infrastructure, Defence, Energy & Engineering Technology sectors. Partnering with a wide range of companies, from SMEs to global engineering brands, we support with anything from one-off permanent hires to fully managed workforce solutions, statement of work, apprenticeships and training.

Based in the UK, Europe and Saudi Arabia, Carbon60 has over 40 years' experience delivering innovative solutions beyond standard recruitment activities.

We are trusted by some of the leading employers in the industry to help navigate the complexities of IR35 with everything from consulting on individual hires, workforce managed solutions, statement of work and payroll solutions.

We aspire to be the most trusted and respected global provider, partner and developer of people in the technical arena.

Proud to be part of the Impellam group, the 2nd largest recruitment business in the UK, we are well-positioned to support you.

If you need any additional information about IR35 or other employment related issues, please don't hesitate to contact us for further information on:

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