

Source's Contractor Guide to IR35.

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Why is Source a trusted recruiter to partner with?

What is IR35?

The new rules are scheduled to come into force in April 2021.

The Government announced the reform of the off-payroll working rules (known as IR35) in the private sector to come into force in April 2021. This follows consultation and the roll-out of the reform in the public sector. The responsibility for operating the off-payroll working rules will move from individual contractors to the organisation, recruitment business, or other third-party contracting with and paying the contractor (the "fee-payer"). Small client organisations are exempt.

The Government consultation closed on 28 May 2019, and on 11 July 2019 the draft legislation, explanatory note, and summary response document were published. Following this, in August the Government published updated guidance on the new rules including guide on the April 2021 changes to off-payroll working for intermediaries.

In March 2020, Covid-19 delayed IR35 by one year to April 2021. IR35 was passed into Primary Legislation in July 2020. It will not be delayed or altered any further. It will come into effect in April 2021.

This guide is designed to help you understand the changes in the legislation and how they will affect you.

When do the off-payroll working rules apply?

Before April 2021, if you are working for a client in the private sector, it is your Limited Company's responsibility to decide your own employment status for each assignment. The new rules mean that the responsibility now falls to the client.

The off-payroll rules apply if a worker provides their services to a client through an intermediary (your Personal Service Company (PSC)) but would be classed as an employee if they were contracted directly with the client.

From 6th April 2021, all medium and large-sized private sector clients with a UK connection will be responsible for determining whether or not the IR35 rules apply i.e. are you "inside" or "outside" IR35? Where the client makes the status determination as "inside" IR35, the contractor's fee will be subject to tax and National Insurance Contributions (NICs).

The deductions will be applied by the "fee-payer" which is the person within the supply chain who hold the contract with your PSC and pays you - this is typically the recruitment business.

Small Company Exemptions

The new off-payroll working rules will only affect medium and large organisations, so "small" end clients are exempt.

A client qualifies as "small" if two of the following conditions apply:

- Annual turnover = Not more than £10.2 million
- Balance sheet total = Not more than £5.1 million
- Number of employees = Not more than 50 employees

The small company exemption applies to the end client, not the fee-payer or the PSC. There is a requirement for clients to state, in their own opinion, if asked, whether they qualify as "small" in a tax year and meet the following conditions:

- The worker personally performs or is under an obligation to perform services for the client
- The client is not a public authority
- The services they provide are under arrangements involving a third party ("the intermediary") and not under a contract directly between the client and the worker.

The client must respond to size-related information requests for the relevant tax year within the later of 45 days of receipt and if they fail to do so within the time limit, the party can apply to the court for an injunction (Scotland) or specific performance under the Court of Session Act 1988 (England & Wales).

The existing off-payroll working rules will continue to apply if you are providing services to a client classed as a "small" company, meaning the responsibility of the status determination remains with the PSC.



Making the Status Determination: Inside or Outside IR35.

The client is responsible for the Status Determinations and deciding if a contractor is "inside" or "outside" of IR35, come April 2021.

Assignments "Outside IR35":

When the client makes the status determination that an assignment is "outside IR35", they must ensure that "reasonable care" is taken when making the decision. If the client does not take reasonable care, the status determination will not be valid, and the client will be liable for unpaid taxes. HMRC have published a [draft document](#) in their Employment Status Manual which outlines the basic principles of what constitutes "reasonable care".

Assignments "Inside IR35":

If the client determines that an assignment is "inside IR35", you need to understand what options of engagement are available as an alternative to an off-payroll model. The options are:

- **PAYE Payroll (agency workers):** Where a recruitment business contracts directly with the worker and operates tax and NICs under agency rules and provides the contractors with worker's rights. The off-payroll working rules do not apply.
- **Umbrella Company:** Where an umbrella company employs the worker directly, the off-payroll working rules do not apply.
- **"Inside IR35" PSC:** If you choose to continue engaging as a contractor via your PSC who is deemed "inside IR35", your recruiter will need to calculate a "deemed employment payment". The deemed employment pay rate is the income of the worker after deductions, including both employee and employer NICs and the Apprenticeship Levy. Neither worker rights nor stakeholder pension rights apply. No expenses allowance applies.

Incorrect determination:

If HMRC disagree with the determination made, they can investigate and insist on back payment of tax, as well as fines for late payment from the fee-payer.

The Key Tests for Status Determinations

To determine whether a contractor will be caught by IR35, key criteria are reviewed to establish employment status.

A decision is made about a hypothetical contract between the contractor and the end-client, and whether, if those two parties were contracting directly, there would be an employment relationship. However, the route to determining employment status is fact-specific and in some cases, there is no clear outcome.

Essentially, if a contractor has similar working conditions, responsibilities, and control as an employee of the client would have, then they are likely to be classed as "inside IR35" (i.e. the off-payroll working rules apply). Case law is evolving constantly in the tax tribunals, courts, and employment tribunals but the key factors that determine a contractor's IR35 status are as follows:

Control and Direction:

In most cases where professional services are provided, it is important that a contractor can demonstrate a certain amount of autonomy in the way they undertake a project. Both the written contract and working practices must show that the client has no influence over how the contractor performs his/her services.

Control factors that may point towards "inside IR35" status include:

- Indicating that the contractor will be supervised
- Including any "staff" benefits (including holiday or sick pay)
- Including start/end/break times
- Contractual clauses that specify any rights of control or supervision over the contractor.

The reality of the situation is that the individual is responsible for the delivery of the services. The individual will determine and control how and when they provide their services to the client, provided that they meet client-specific targets or project completion dates. It is worth noting that any clauses referring to control should be reflected in both the first-tier (between recruitment business and client) and the second-tier contracts (between recruitment business and contractor).

Financial risk:

The contractor may take on a level of financial risk in undertaking the engagement. Contractors who don't take any financial risk, for example don't have to rectify poor quality services at their own cost, are more likely to be "deemed employees" for tax purposes. Contractors taking financial risk would also be expected to maintain appropriate insurances.

Substitution:

A genuine right of substitution has long been deemed to be a very important factor when demonstrating that a contractor's assignment falls "outside IR35". For a substitution to be considered valid, the right to supply a substitute must be a genuine one. This means that the client must agree to it in practice, the contractor must pay for substitute, and it should be an unfettered right. An unfettered right of substitution means that a client must accept a substitute if the initial contractor is unavailable. HMRC have now qualified the criteria within the CEST question on substitution, which states that a client's need to be satisfied that the substitute has the skills and experience requires or to ensure the substitute is approved under their security processes does not negate the right of substitution.

Mutuality of Obligation:

In essence, it is an obligation between the parties to provide and accept work. In an employer/employee relationship, mutuality of obligation is easy to establish. However, HMRC states that by having a contract agreeing to provide services, mutuality is established but most experts consider the legal picture to be more complex. It is likely there will be more clarity around this in the coming months. Other factors include:

- Provision of equipment
- Any absence procedures
- Continuity of the engagement
- Termination agreements
- Notice periods
- If the contractor has become "part and parcel" of the organisation

Examples of Status Determinations

HMRC have produced scenarios of Status Determinations. Below are two examples:

HMRC Examples

Off-Payroll working rules apply ("Inside" IR35)

Rebecca works through her own PSC as an IT Product Designer at the Ministry.

- Rebecca will be working at the Ministry's IT Development Centre
- She is not required to supply her own equipment
- Rebecca will work under the direction of a Senior Manager
- Flexible working hours are available, but Rebecca will need to arrange time off with her manager

Off-Payroll working rules do not apply ("Outside" IR35)

Jasmine is a Web Designer, contracted to a large local authority through a PSC to design and build a website. She will:

- Deliver the website to an agreed standard by the agreed date
- Visit the council's offices for meetings, but mainly work from her own office
- Provide her own equipment needed to do the job in hand
- Employ her own staff to help deliver the contract if she needs to cover her own costs and expenses

She is not filling a role, but rather providing a whole service, the fees for which covers her equipment, time, and staff costs (should she want/need to engage others to assist on the project).

Frequently Asked Questions

Q: I work for lots of clients, does IR35 still apply?

The new rules will still apply irrespective of how many clients and assignments a contractor is working on. Your IR35 status is assessed on an assignment basis - working for multiple clients is not a significant indicator of being in business on your own account; the IR35 status for each assignment is assessed on its own merit.

Q: The client does not understand/will not apply the new IR35 rules, do I need to worry?

With the new rules, if the client fails to make a status determination, fails to pass the status determination down the supply chain, or fails to take reasonable care when making a status determination, then the client is liable for the tax and NICs as the deemed "fee-payer". If you are providing services to a small client, this is exempt and your PSC will remain responsible for determining your IR35 status.

Q: Can I be involved with the client's Status Determination?

It is expected that you will be involved to some degree in the client's status determination process. There will be some questions that require the contractor's input, for example, questions on how you run your business. However, there is no statutory right for a contractor to be consulted during the status determination process.

Q: Will my rate be affected by the new rules?

If your assignment falls "inside IR35", the take-home pay will be less as the recruiter has a statutory duty to deduct the appropriate tax and NICs. Be aware that historically, PAYE rates have always been lower than PSC rates so you may find that in the future pay rates offered are lower.

Q: Can I be forced to pay for the employer's NICs?

Recruitment businesses cannot lawfully deduct secondary NICs from an agreed fee, but the recruitment businesses may adjust the contractor's pay rate to factor in the additional costs of supply which include employers' NICs.

Q: Can I set up a shared PSC to facilitate my right of substitution?

There are suggestions that contractors could set up a limited liability company with a small group of contractors.

Frequently Asked Questions

Q: Can I convert to working under a Statement of Work (SOW) contract?

There are concerns about converting a current time and materials contract to an SOW contract as the contract must accurately represent the reality of what happens during the assignment. However, for new assignments with new clients, this is an option for highly skilled contractors.

In an assignment where a contractor agrees to perform specific tasks or deliver certain outcomes for a set price and within an estimated delivery time, there is less likelihood of the client exerting control over the individual. An SOW contract, if appropriately executed, is likely to be "outside IR35", compared with the traditional time and materials-based contract on a set hourly or day rate.

It is more likely that an assignment will fall "outside IR35" if the performance of the services carries a genuine business risk, e.g. payment is conditional upon acceptance of services or satisfactory performance, and rectification of defects or poor performance are made at the contractor's cost. Although this may seem like an easy option to adapt to the new rules, you will remain at risk if the reality of the contractual performance does not reflect the contractual wording. Please note that not all assignments are appropriate as an SoW contract, this will depend on whether the recruiter and the end client offer this option.

Q: My assignment is for 2 years - is it automatically "inside IR35"?

The 24-month rule is in reference to claiming travel expenses. This rule has no bearing on the IR35 status of an assignment.

Q: I do not agree with the client's status determination, can I appeal it?

Representations that the status is incorrect can be made by the worker or deemed employer at any time up to when the final chain payment is being made for an engagement (Section 61T (1) Chapter 10, Part 2 ITPEA 2003). The client must give a statement to the worker or the deemed employer (depending on who made the representations) that either the SDS is correct with reasons or give a new SDS, stating the date from which the client considers that the conclusion in the new SDS became correct and stating that the previous SDS is withdrawn. The deemed employer is deemed to have received a reply from the person above it in the supply chain.

The client has 45 days beginning with the date the client receives the representations to respond. If it fails to meet that deadline then from that date on it carries fee payer liability until it complies.



What are we doing to support our Contractors?

Source has always taken compliance with legislation very seriously right from when we opened our doors some 30 years ago. Operating as a compliant business protects our clients and candidates, so this has and always will be a huge focus and investment for us.

So what are we doing to help our contractors?

Education is key - we have held an IR35 Event for our clients focused upon guiding them through a four-stage methodology to enable them to create a plan to ensure they can continue to benefit from a flexible workforce come April 2021.

We have developed a number of products to support our clients with the various stages of their planning and roll out which ensures they partner with the best suppliers and specialists on IR35 to ensure you get a fair assessment moving forward.

We have rolled out a number of internal training initiatives to ensure we ourselves can be as educated on the IR35 subject to enable us to support you through these changes.

We remain committed to our contractors to do the best by you and will work hard to navigate you through the challenges these changes in legislation brings to our doors.



Annika de Friend
Founding Director