

IR35 in the private sector



Key considerations for contractors before April 2020.

Large and medium-sized organisations have just six months left to prepare for changes to off-payroll working rules, which are due to extend to the private sector next spring.

From 6 April 2020, firms that engage private-sector contractors will be responsible for deciding if the rules should apply and deducting income tax and national insurance.

At present, contractors who operate through their own personal service company (PSC) have these responsibilities, but the extension of the off-payroll working rules will soon make it the responsibility of the organisation engaging them.

HMRC predicts the measure, confirmed in Finance Bill 2019, to affect around 170,000 individuals who operate through a PSC.

Around 60,000 firms that utilise contractors via PSCs, and 20,000 recruitment agencies, are expected to be affected.

Companies that engage off-payroll workers will be affected by the rules if they are not considered to be a small company.

A company is deemed 'small' if it satisfies two of the following criteria for two consecutive years: its annual turnover is less than £10.2 million, its balance sheet is less than £5.1m or it employs fewer than 50 members of staff.

The rules which determine who is or is not within IR35 are not changing, only who is held legally responsible if those rules are not correctly applied.

Aims and controversy

IR35 was introduced with the aim of tackling tax avoidance where workers supplied services through an intermediary.

That was back in 2000, and HMRC believed those self-employed workers were effectively being treated as employees but not being taxed through payroll as employees ought to be.

This is what the Revenue considers to be 'off-payroll' services.

The new off-payroll rules were extended to the public sector in April 2017 and have seen some organisations lose, and struggle to replace, valued contractors. As such, projects have either been delayed, cancelled or seen costs increased.

Tom Hadley, director of policy at the Recruitment and Employment Confederation, said:

“IR35 rules are a huge problem for employers and contractors. They need to be clear to be effective. “The last thing private-sector businesses need at this time of Brexit uncertainty is rushed or poorly-designed tax rules that add further uncertainty to an already fragile business landscape.”

Recent inconsistencies

HMRC recently wrote to 1,500 PSCs that supplied services to pharmaceutical giant GlaxoSmithKline (GSK) in 2018/19.

It asserted that the off-payroll rules would extend to all recipients from next April, despite some PSCs providing services through an intermediary, such as an agency, and therefore having no contract with GSK – a fact overlooked by HMRC.

It also erroneously cited the need for PSCs caught by the IR35 rules to run payroll each month.

Applying the IR35 rules to private-sector PSCs will involve a calculation of a ‘deemed employment payment’ at the end of each year, not already made through monthly or weekly PAYE.

The rules

As a specialist who might consider contracting, a combination of factors need to be considered to determine if you should operate as an employee or remain self-employed, although some factors carry more weight than others.

Mutuality of obligation

Employees and employers have to sign contracts that oblige the former to perform continuing work and the latter to pay the former for that work.

This is what is known as the mutuality of obligation, but there is no continuing obligation on either side when it comes to self-employment agreements.

That’s because a self-employed individual can choose projects with no obligation to accept them, while a customer has no obligation to offer work to keep them busy.

Substitutions

Contractors who work through a limited company and wish to remain outside of IR35 after April 2020 should ensure a genuine right of substitution exists throughout each contract.

To stay outside of IR35, you need to be able to show to HMRC that someone of equal competence, supplied by you, could have carried out the work to the same standard. In other words, that they’re paying for a service, not for you.

Should a client specifically ask for you to do the work and reject a colleague who is equally qualified, the Revenue may interpret this to mean that you are inside IR35.

Proving self-employment

Bringing your own tools and equipment is one way of proving to HMRC that you are self-employed, as is having several different customers at the same time.

Similarly, taking on financial risk by being willing to correct work in your own time and at your own cost, or being paid after submitting an invoice after completion of the task, is proof.

Checking employment status

Much furor surrounds the shortcoming of HMRC's 'check employment status for tax' (CEST) tool.

The tool was designed to help determine if a contract is inside or outside of IR35, but excludes the mutuality of obligation.

Prior to the Finance Bill's publication in July 2019, the Institute of Chartered Accountants in England and Wales gave the CEST tool a vote of no confidence due to this omission.

HMRC currently assumes that a person has already established mutuality of obligation before they use its CEST tool, but it is looking to enhance the tool and is testing these 'enhancements' with the intention of rolling them out before April 2020.

Expenses allowance

Contractors who work inside IR35 on private-sector projects through a PSC will be able to reclaim 5% of gross annual income earned for administrative expenses in calculating the deemed employment payment.

'Administrative' includes costs relating to premises, admin support, accountancy advice, professional indemnity insurance, computer equipment, training, seeking contracts, printing and stationary, and bank or overdraft interest. You do not need to demonstrate this expenditure.

The 5% allowance is not available to employees as an expense they can draw from the company.

Options to prepare

If you are a private-sector contractor who is likely to fall within IR35 next year, it's likely you are already underpaying tax now.

It is currently your responsibility to determine whether or not you are within the off-payroll rules.

From next April, once this determination is no longer yours to make, this option will not remain on the table.

Just in case HMRC's reform to the CEST tool is not delivered before next April, establishing whether or not you will be treated as an employee or within the off-payroll rules before using the tool would be a good place to start any preparations.

If it looks like you will fall within IR35, weigh up whether or not you would be better off becoming a permanent employee.

One multinational bank made many contractors permanent, so they will be taxed as employees before the changes take effect.

Some limited companies, particularly those in IT, are closing down before the rules extend to the private sector.

Other contractors are deciding to close down their company to take on temporary assignments through an umbrella company.

Another option would be to get to grips with the finer details of your contracts in the event HMRC sends you a full inquiry letter or formal information request.

Talk to us about IR35 in the private sector.