

Contractor Guide to the IR35 Off-Payroll Rules

December 2020



The extension of Off-Payroll rules to the private sector is set to come into force on 6th April 2021.

This guide is based on the legislation which received Royal Assent in July 2020, but should not be seen as a substitute for taking your own legal advice.

Background

The IR35 legislation is intended to ensure that where individual contractors operate like employees their earnings are treated as employment income and taxed accordingly, regardless of the limited company or limited liability partnership structure the contractor works through.

IR35 applies where an individual (the contractor) provides their services through an intermediary (the agency) to another person or entity (the client).

What is changing?

Under current private sector IR35 legislation, a limited company contractor ('PSC') is responsible for assessing the IR35 status of each of their assignments. The PSC is also liable for any failure to apply IR35 correctly and for any errors in PAYE income tax and National Insurance Contributions (NICs) made. To date, private clients and agencies haven't had to involve themselves in the PSC's IR35 status. This is one of the key areas that will change when the new rules come into effect.

As you may recall the reforms due to be implemented in April 2020 were suspended until April 2021 because of the COVID-19 pandemic. When the reforms come into effect on 6 April 2021, they will extend to the private sector, and slightly modify, the Off-Payroll working rules, which came into force in the public sector in 2017. This will mean that private sector clients will be required to determine the IR35 status of a PSC's working practices in a particular assignment. They are also required to communicate that determination to the party responsible for paying the PSC (the 'Fee Payer') – usually the agency paying the PSC (but if there is no agency then the client itself). If the assignment is determined as inside IR35, the Fee Payer will need to make deductions for employee PAYE income tax and National Insurance, as well as paying any employer NICs.

This "deemed employment relationship" is for tax purposes only and doesn't grant any employment status rights to the PSC representative (i.e. the individual working through the limited company structure). It also doesn't impose any statutory payment obligations on the Fee Payer, such as paid holiday, statutory sick pay, maternity pay, paternity pay etc.

Assignments “Outside IR35”

If the client classifies the assignment as being “outside IR35” the contractor can continue to work through their PSC as normal.

Assignments “Inside IR35”

If the client classifies the assignment as being “inside IR35” the contractor has three options available:

1. Become a PAYE Temporary Worker via Rullion – Rullion will contract with the contractor directly as a ‘worker’ and will make deductions from the worker’s income for PAYE income tax and National Insurance. The worker will also be entitled to worker rights such as holiday pay, statutory sick pay, maternity pay, paternity pay and will be auto-enrolled into a pension scheme etc.
2. Become a PAYE Temporary Worker via an Umbrella Company – the Umbrella Company will employ the contractor as an employee directly and make deductions for tax and National Insurance. The Temporary Worker will also be entitled to worker rights such as holiday pay, statutory sick pay, maternity pay, paternity pay and will be auto-enrolled into a pension scheme etc.
3. Remain a contractor working inside IR35 PSC – Rullion will refer the contractor’s limited company to a 3rd party which can make deemed employment deductions for both Employers and Employee National Insurance and income tax to calculate a “deemed employment payment”. The contractor will not be entitled to worker’s rights.

Determining IR35 Status

For an accurate IR35 status determination the client must assess the actual day-to-day working practices that will apply to an assignment that both they and the contractor can expect to engage in. No single factor will be dominant. It’s the overall picture that HMRC is interested in. The key factors considered in the determination are as follows:

Control

Who determines what, when, where and how the work is done, the client or the contractor?

The contractor will need to be able to demonstrate a significant level of autonomy. The contractual documents and the working practices must show that the client has little to no influence over how/where/when the services are performed.

If the client has control, then this will tend towards an inside IR35 determination. If the contractor has control this will tend towards an outside IR35 determination.

Mutuality of obligation

Does the client have to offer work and does the contractor have to accept it?

Mutuality of obligation is the obligation between master and servant to provide and accept work.

If mutuality of obligation exists between contractor and client, this will tend towards an inside IR35 and vice versa.

Personal service and the right to substitution

Does the contractor have to provide their services personally or do they have a genuine right of substitution, and if so, has it been exercised and how was the substitute paid?

If the contractor doesn't have to provide services personally and does have a right to put in a substitute, this will tend towards an outside IR35 determination and vice versa.

The right to substitution must be genuine and the client must accept a substitute if the initial contractor is not available to complete or provide the services. The right must be unfettered, which means the client can only reject the substitute based on the substitute not having the required expertise or security clearance. Any substitutes need to be paid by the contractor.

Other potentially relevant factors

Is the contractor taking a financial/ business risk such as having to make good any defects?

Is the contractor required to deliver a specific piece of work with defined outcomes and is payment based on those outcomes being delivered?

If the answer to these questions is yes, then this will tend towards an outside IR35 determination and vice versa.

The contractor may have to take on financial risk in rectifying a defective service at their own cost. Alternatively, he/she may have a contractual agreement in place that stipulates payment is conditional upon acceptance/satisfactory completion of services.

Other factors to be taken into account include: the contractor providing their own equipment and the contractor being genuinely independent and not having become "part and parcel" of the client.

If the working practices in an assignment are determined "inside IR35", the PSC's earnings will be treated as deemed employment income and paid by the Fee Payer (usually the agency) after deduction of PAYE income tax and NICs.

Which private sector clients are within scope of the new rules?

The private sector legislation will apply to medium or large organisations only.

The statutory definition of what constitutes a small company in the Companies Act 2006 is used to determine whether a corporate client is identified as “small” and therefore outside the scope of the Off-Payroll rules.

Section 382 of the Companies Act 2006 highlights the relevant provisions of qualifying as a small business:

If in a year a client company satisfies two or more of the following requirements:

1. Annual turnover not more than £10.2 million;
2. Balance sheet total not more than £5.1 million;
3. Number of employees not more than 50; it will be a small company and outside scope.

Disputing an inside IR35 determination by a client

The legislation (as currently drafted) makes provision for the contractor to challenge the client’s status determination if they don’t agree with it. This needs to be done in writing, giving reasons why the contractor disagrees with the determination. The client must respond within 45 days and will either confirm the original determination or provide a new status determination. The initial client determination will stand during the dispute process. If the client confirms the original determination, the PSC’s only further means of challenging it would be direct with HMRC through their tax return at the end of the relevant tax year.

Frequently Asked Questions

Q: I am a limited company contractor and have always worked outside IR35. How will the proposed changes affect me?

Under the current IR35 rules, you determine your own tax status. Neither Rullion nor the Client have any input. From April 2021, however, it will become the Client's responsibility to assess and determine the IR35 status of the working practices for each assignment.

The Client's IR35 status determination will have one of two outcomes:

1. The assignment will be assessed as outside IR35 and you'll carry on as you are now;
2. The assignment will be assessed as inside IR35 and you'll need to change your payment method as the fee payer will become responsible for deducting income tax and NICs from your pay. This will either be:
 - through the Rullion payroll as a PAYE temporary worker;
 - via an umbrella company on a PAYE basis; or
 - by Rullion under the new Off Payroll rules as a net payment to your limited company after Rullion have deducted income tax and NICs at source from your invoice.

Q: If my assignment is determined inside IR35, what will the various payment options I could choose from look like in practice?

1. PAYE via Rullion – Rullion will contract with you personally under a contract for services. You'll be a worker and accordingly, Rullion will make deductions for tax and national insurance from your gross pay. You'll also be entitled to worker rights such as holiday pay, statutory sick pay, maternity pay, paternity pay and you will be auto enrolled into a pension scheme, etc.
2. PAYE via an Umbrella Company – the Umbrella Company will employ you directly and make deductions for tax and national insurance from your gross pay. You'll be entitled to employee rights.
3. Inside IR35 PSC – Our 3rd party paying agent will engage with your limited company and make deductions for both Employer's and Employee's National Insurance and income tax from your invoiced amount to arrive at a "deemed employment payment". As Rullion will be contracting with your limited company, you will not be a worker and will not be entitled to worker's rights. However, as an inside IR35 contractor, you will not be in business on your own account and will therefore be in scope of Agency Workers Regulations 2010 and entitled to the same pay and working conditions as if the client had employed you directly.

Q: If I work under a Statement of Work arrangement will I be outside IR35?

That will depend on the circumstances. Your contract must reflect the actual day to day working practices. If you are simply converting a current time and materials contract to a Statement of Work ('SOW') contract there would be a concern that a SOW arrangement would not reflect your actual day to day working practices. However, SOWs are an option for new contracts, especially for highly skilled, autonomous contractors who are often engaged to deliver a specific project within a specific timeframe / specific deliverables and for a fixed price. If properly executed, SOW contracts are more likely to be "outside of IR35", as there is less likelihood of client control and the overall service provider and the contractor bear a genuine financial risk.

Q: How will my take-home pay be affected by the new rules?

If you have historically treated yourself as outside IR35 and your assignment[s] is/are now determined by the client as being inside IR35 then, from 6 April 2021, your income from such assignments will be deemed employment income and subject to income tax and NICs deductions. Employer's NI will also be paid on your account to the statutory authorities by the Fee Payer (usually the agency).

Where assignments fall inside IR35, contractors who have previously treated their earnings as falling outside are likely to see a drop in net income.

HMRC has said it will not apply the Off-Payroll rules retrospectively and that it is not interested in events prior to 6 April 2021.

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

Yes, it does apply as your status is assessed on an assignment by assignment basis which means you could work on "inside IR35" and "outside IR35" assignments throughout the year.

Q: Do I get worker's rights if I am inside IR35?

Being inside IR35 is a tax determination and does not automatically give worker rights such as paid holiday, statutory sick pay, statutory maternity/paternity pay or pension etc. If you continue to work through your limited company, then you will not be a worker for the purposes of such rights. As an inside IR35 contractor you will, however, be within the scope of the Agency Worker Regulations 2010 (AWR) because you'll not be in business on your own account.

Alternatively, if you decide to work on a PAYE basis directly through Rullion or via an Umbrella Company, you'll be entitled under AWR and also to the workers' rights listed above.

Q: As all income paid after 5 April 2021 will be subject to the new rules, how can I ensure that payment for all work done prior to 5 April 2021 will be made before the new rules take effect?

It may not be possible to make payment for all work done before 5 April 2020 before that date. However, HMRC has stated that payment for work done prior to 5 April 2020 should be as close to this date as possible.

Q: Will my PSC be at risk of retrospective tax claims by HMRC if the client determines my ongoing assignment as inside IR35 post April 2020?

HMRC have said they will not make retrospective claims against limited company contractors if they change their status from outside to inside IR35 in April 2021. However, there have been circumstances where retrospective claims have been made against contractors operating in the public sector so we can make no guarantees as to HMRC's future actions.

Q: What if I disagree with the client's inside IR35 determination of my assignment?

If the client concludes your assignment is inside IR35, you can ask for reasons and the Client must provide those reasons to you within 45 days. That doesn't mean the Client is bound to change their determination. You should seek to understand why the working practices relevant to the assignment you'll be undertaking, or you are currently working on, have received an inside IR35 status determination. There may be circumstances in which you and the Client can structure your ways of working to put the assignment outside IR35, provided that the structure you put in place is genuine and sustainable.

However please be aware that the Client has a responsibility to exercise 'reasonable care' when making determinations which means they must ensure that the information they input into an assessment, whether through a third-party assessor, CEST, or their own in-house teams, is accurate and truthful.

Q: What happens if I still disagree with the outcome?

If you cannot genuinely structure your ways of working to be outside IR35, then you'll have no choice but to accept an inside IR35 determination and the consequent deductions if you want to continue in the role post-April 2021. You can appeal your status with HMRC through your tax return, so you should speak to your accountant for more details on going down this route.

Q: How will this affect future roles?

Assignments that are genuinely outside IR35 will be unaffected. It's likely that in the future, roles will be advertised as either inside or outside IR35 so there will be clarity from the outset.

Q: If I decide to go down the umbrella route, what precautions should I take when choosing an umbrella company?

There may be a number of umbrella companies in the market that start to offer tax avoidance schemes to maximise take-home pay. This is something we saw when the reforms were introduced in the public sector. These arrangements leave contractors at risk and can lead and have led to HMRC claims for additional tax, NICs, interest and penalties down the line.

Signs of tax avoidance schemes include:

- promises to provide the contractor with 80, 90 or 95% take-home pay and claims to be tax compliant (this is unlikely to be true as, in most cases, the basic rate of Income Tax is 20% and National Insurance contributions are also due on earnings)
- Only a fraction of the salary is paid through payroll and subject to PAYE (indicating that tax is only paid on some of the income)
- Payments are made using a loan, credit or investment payment and the company claims this isn't subject to income tax or NICs (this is tax avoidance)
- The payment from the umbrella company is routed through various companies before it comes to the contractor

It's essential to only work through reputable and compliant umbrella companies. Rullion will only work with FCSA or Professional Passport accredited umbrellas on our preferred supplier list.

Find out more

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