

IR35 Reforms

A Guide For Agencies & End-Hirers



IR35



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Introduction

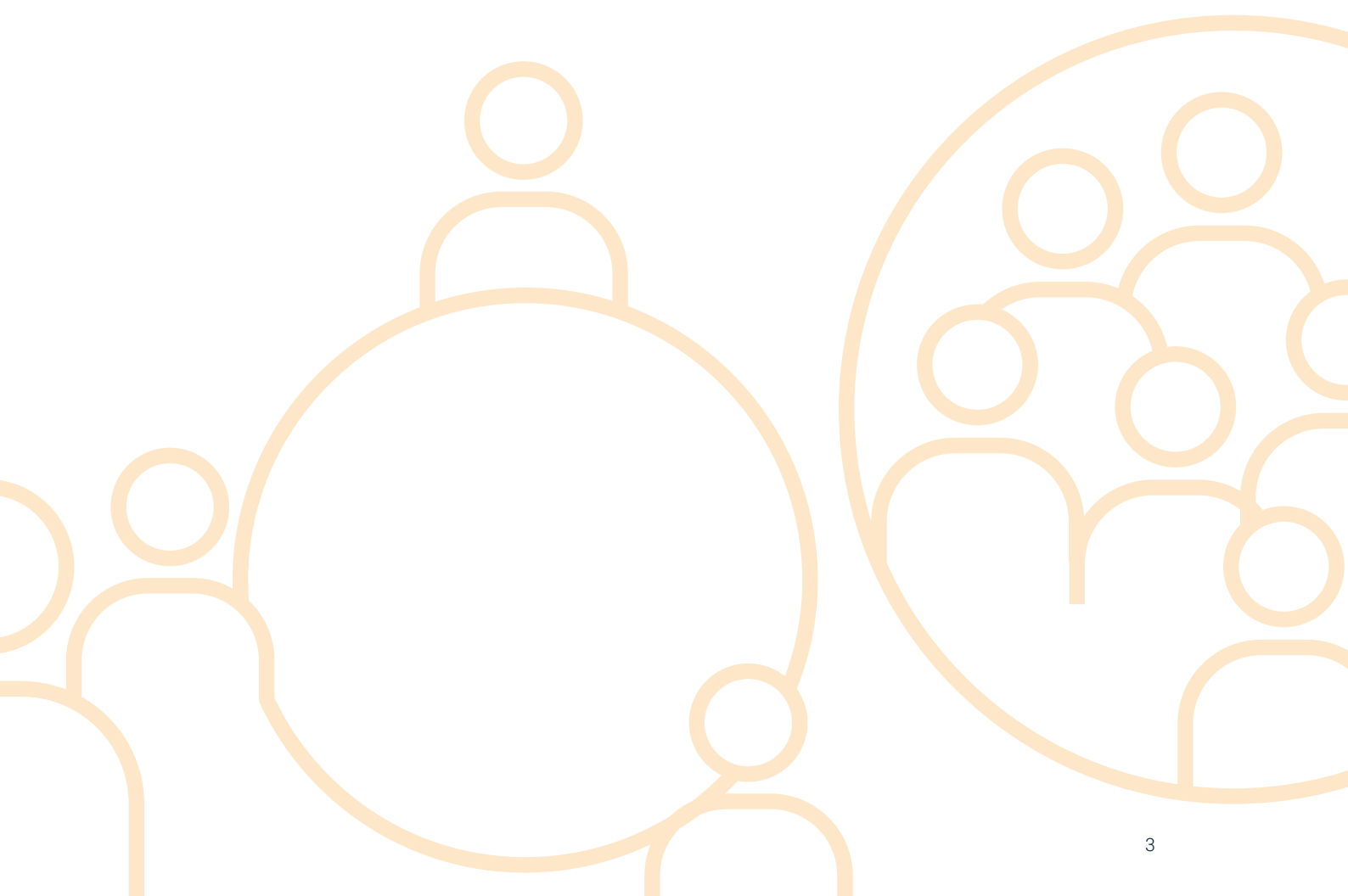
Reforms to IR35 rules in the private sector are due to come into effect in April 2021.

They apply to large businesses and mean that responsibility for determining a contractor's IR35 status and ensuring the correct taxes are paid will switch from the contractor to the companies that engage them (the 'end hirer'). Liability for proper taxation will ultimately rest with the end hirer, but HMRC will often look to collect first from employment agencies.

If you're an end hirer or employment agency, you need to fully understand the IR35 reforms and take steps to ensure you are compliant.

We have produced this useful guide in collaboration with IR35 experts at FCSA Accredited Member firm JSA Group to help you make sense of these complex rules, explaining what is changing, the risks and how to mitigate them, and how to determine a contractor's IR35 status.

We hope you find this guide helpful.





What is IR35?

IR35 is tax legislation that aims to stop individuals from avoiding tax by supplying their services to the client through an intermediary, such as a limited company (Personal Service Company - PSC).

The legislation is designed to identify contractors and businesses that are avoiding paying the appropriate tax by working as what HMRC refers to as 'disguised employees', or are engaging workers on a self-employed basis to 'disguise' their actual employment status.

IR35 is a term that is now used collectively to describe the original and more recent relevant parts of the Income Tax (Earnings and Pensions) Act. These deal with the 'old' IR35 rules, which were the responsibility of the contractor to operate, and the 'new' IR35 rules, where other parts of the supply chain have responsibilities as well. The new and old IR35 can both potentially be relevant after April 2021, depending on the nature of the supply chain. Off-payroll is also used to describe the same collection of tax laws.

The Reforms

When IR35 first came into force in 2000, each contractor was responsible for assessing their own IR35 status. Therefore, the contractor's limited company or employment agency was responsible for paying any tax or National Insurance Contributions (NIC) due.

In 2017, the rules changed for the public sector, whereby the responsibility for ensuring the correct IR35 status shifted from the contractor to the public sector body engaging them. The rules for contractors in the private sector remained unchanged at this time.

On 6 April 2021, new IR35 legislation will come into effect for the private sector to align how a contractor's IR35 status will be determined with the public sector.

It's important to note that the test behind IR35 – the employment status test - isn't changing; it's the liability for ensuring compliance that will be different under the new rules.

Therefore, it is essential for end hirers and employment agencies, and contractors to be fully aware of the changes, the implications for their business, and how to ensure compliance.

What's changing?

When the IR35 changes come into effect in April 2021, the responsibility for determining a contractor's IR35 status and paying relevant tax will be passed to the companies engaging them. In turn, what that means, is the engaging companies (e.g., end hirers or employment agencies) will be held liable should HMRC decide that status is incorrectly assessed.

However, the IR35 changes in the private sector exclude 'small businesses,' meaning that contractors working for them will continue to determine their own IR35 status for tax purposes.

Inside IR35 Meaning

To be 'inside' IR35 means that you are considered, for tax purposes, an employee of your end hirer and therefore subject to PAYE.

Outside IR35 Meaning

To be 'outside' IR35 means that you are operating as a genuine business, and therefore operating outside of the IR35 rules. This means that you are able to pay yourself a salary, draw the remainder of income as dividends, and remain responsible for your taxes as usual.



The Reforms

Here is a helpful summary of the fundamental changes to the current IR35 rules in the private sector:

Current Rules	New Rules
<p>The contractor is entirely responsible for working compliantly and paying the correct taxes.</p> <p>If a contractor undertakes an 'outside' IR35 limited company assignment, the contractor's limited company is paid a gross rate by the agency.</p> <p>This money can be withdrawn from the contractor's company in a very tax-efficient manner using salary, expenses, and dividends under HMRC rules.</p> <p>If the assignment is later judged not to be outside IR35, the contractor will be liable for all of the unpaid tax plus any penalties and interest levied.</p>	<p>The end hirer is responsible for the IR35 assessment. But the agency is liable in the first instance for the payment of unpaid taxes should HMRC successfully challenge the assessment.</p> <p>The end hirer now takes responsibility for deciding this status of an assignment, whether it is 'inside' or 'outside' IR35.</p> <p>The end hirer will have to issue what is known as a Status Determination Statement (SDS) to the agency and the contractor.</p> <p>In theory, if the end hirer issues an 'inside' IR35 SDS, then they have complied with their obligations. If your agency (and any other agencies in the supply chain) then ensure that the contractor is paid via PAYE and taxed as a normal employee (e.g., via a compliant umbrella company), there is no liability risk for anyone.</p>

A 'Status Determination Statement' (SDS) is a comprehensive statement from the client which declares a contractor's deemed employment status following an IR35 assessment.

Responsibility and Liability

The new rules come with significant compliance and tax risks for both agencies and end hirers. The agency is the first port of call for HMRC should a successful challenge be made to an 'outside' IR35 status assessment.

Each partner in the supply chain could protect itself, but there is no way to remove liability altogether.

- **End hirer** – if an 'inside' IR35 determination is given, the end hirer passes on the liability if it does the assessment using reasonable care and passes that on correctly. In the case of an 'outside' determination, the risk remains with the fee payer (the agency) and the end hirer.
- **Agency** - in the case of an 'inside' IR35 determination, the agency passes on liability if there is another link in the supply chain, and it can be shown that the decision was correctly passed onto the next party.
- **Separate fee payer** - if there is a separate fee payer and tax was not paid when HMRC thinks it should have been, then the fee payer is the first port of call. However, if HMRC can't collect from the fee payer, then they go to the agency. If they can't collect from the agency, they go to the end hirer.

If an accurate, professional assessment is done, there should be no challenge from HMRC, which means that a high-quality assessment is critical. Risk is further mitigated if the outcome of the SDS is insured.

The following diagram illustrates responsibility for liability:

Pre-April 2021



Post-April 2021





The Risks

Risk: End hirer makes an 'outside' IR35 decision

If HMRC successfully challenges an 'outside' status, the liability for unpaid tax sits first with the company that pays the contractor's limited company, then the top agency in the chain supplying the worker to the end hirer, even though the end hirer made the 'outside' IR35 status determination in the first place. If the fee payer or top agency in this chain can't or won't pay, the liability goes up to the end hirer.

Solution: Using a reliable (and possibly insurance-backed) assessment tool, agreed between the parties. That way, all members of the supply chain can be sure the 'outside' IR35 determination is as safe as possible, and liabilities minimised.

Risk: End hirer makes an 'inside' IR35 decision

Even if the worker is treated in a compliant manner by the end hirer and the agency, there is still a risk to the end hirer if, further down the supply chain, the contractor is paid by another party as an 'outside' IR35 contractor.

In this case, the liability would sit first with the company that paid the contractor's limited company. The top agency in the chain supplying the worker to the end hirer (next to the end hirer), which may be your agency or an agency that you supply, will be next in line, even if that agency has itself acted compliantly. If the agency can't or won't pay, the liability moves up to the end hirer.

Solution: Pay workers via a compliant PAYE model such as a compliant umbrella or outsourced employment solution, but ensure full visibility with all workers going through one compliant supplier engaged near the top of the chain.

Risk: Commercial risk - costs increase/talent is lost

Many contractors and contracting roles have been accustomed to being paid using the 'outside' IR35 limited company route. When this changes to 'inside' IR35, having to be paid via PAYE (e.g., taxed as an employee), the employment cost is greater, and the contractor will face a higher tax bill on the income they receive.

The agencies then pay the same rate to the contractor. The company paying the contractor now has to deduct employment expenses (e.g., employers National Insurance (NI), pension, and the Apprenticeship Levy) from the rate they receive before passing it on to the contractor. From the reduced rate that the contractor gets, they will have to pay a larger proportion in PAYE and employees NI.

Some contractors may refuse to work on this basis. Consequentially, end hirers and agencies that no longer engage contractors via a limited company may be left with a skills gap and the risk that talent will transfer to a competitor. For the contractor to receive the same net pay, the end hirer/agency would need to add an additional amount to the contractor's rate to cover these extra taxes and costs of employment, increasing costs to the supply chain for engaging important resources.

Solution: Ensure that all contracts/roles will be assessed using a reliable assessment tool will stop this will give you the confidence to continue placing as many contractors as possible in the 'outside' IR35 category, maintaining a competitive advantage over those that choose to cease engaging in this way.



Determining IR35 status

From 6 April 2021, end hirers will need to issue an SDS for every contract engagement, unless they have a policy of only engaging with employed models such as agency PAYE or a compliant umbrella company. Before that, the supply chain will need to have classified all existing and ongoing assignments as either 'inside' or 'outside' IR35.

HMRC has developed a tool called CEST – Check Employment Status for Tax. You may find this tool useful to understand how HMRC determines whether an assignment is 'inside' or 'outside' IR35 but be warned; it is just a guide.

While HMRC states that they will stand by the results generated through CEST, it is widely viewed by experts in the field as unreliable. In addition, some users of the CEST tool in the public sector have ended up with bills for additional tax.

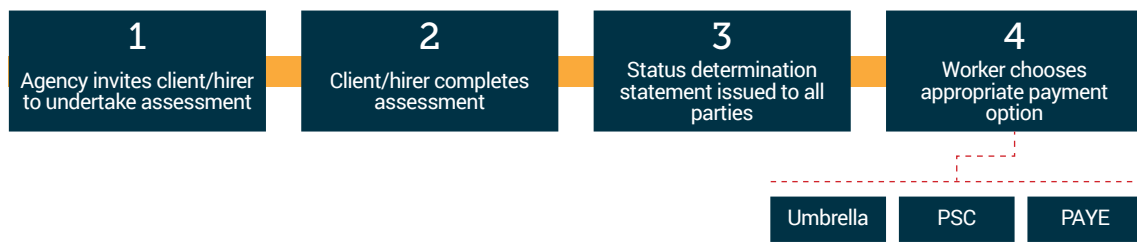
Determining the IR35 status of your contractor workforce is complex. There are a wide range of online tools and providers available. We suggest that you only use these alongside appropriate insurance if possible for your peace of mind and protection, but ideally, you should seek expert, individually tailored IR35 advice.

Example of Contractor Assessment Process



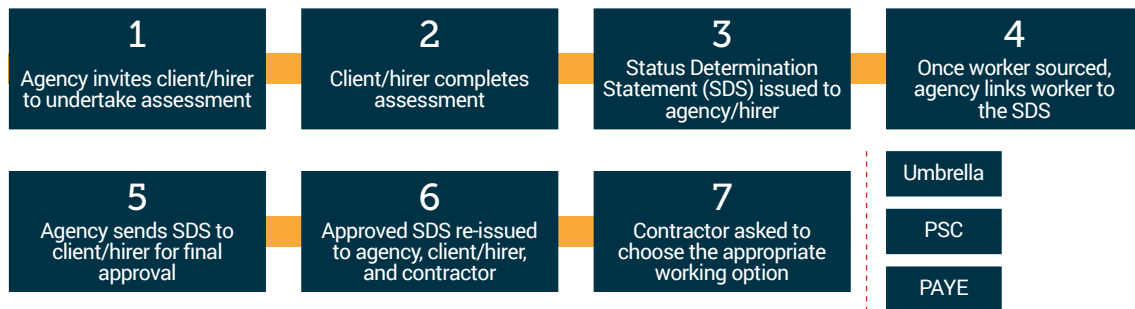
Source: JSA Group

Example Individual Contractor Assessment Process



Source: JSA Group

Example Role Assessment Process



Source: JSA Group

HMRC can examine the contractor’s tax status at any time. There are many factors that HMRC will assess to determine whether or not a contractor is operating ‘inside’ or ‘outside’ IR35, and the factors can vary from assignment to assignment.

When evaluating whether someone is ‘inside’ or ‘outside’ IR35, HMRC will initially disregard the written contract and instead consider the contractor and business’ relationship to create a ‘notional contract.’ You will need to demonstrate that the contractual clauses are in agreement with the working practices in place in the supply chain.

HMRC looks at the following areas when determining a contractors status:

- **Control:** How much power does the business have over what, how, when, and where the contractor completes the assignment? The more control, the more likely the contractor is ‘inside’ IR35.
- **Substitution:** Can someone else complete the assignment, or is it contractor and person-specific? The more likely the contractor is ‘inside’ IR35 if the latter applies.
- **Mutuality of Obligation:** Is the business obligated to provide work? Must the contractor accept it? If the answer is yes, then the contractor is probably operating ‘inside’ IR35.

HMRC will also consider the type of contract, any financial risks for the contractor, their role in the organisation, and whether the company provides the equipment. Finally, all of these factors will be considered together, to form an overall impression of whether the engagement is effectively one of employment, or not.

Putting in place a robust and transparent assessment process means that limited company (PSC) contractors can continue to be used where appropriate and alternative contracting payment options (e.g., PAYE/PEO or umbrella) can be used for assignments which are ‘inside’ IR35.

You must keep detailed records of assessment, including CEST outcomes.



Payroll Solution: Umbrella Employment

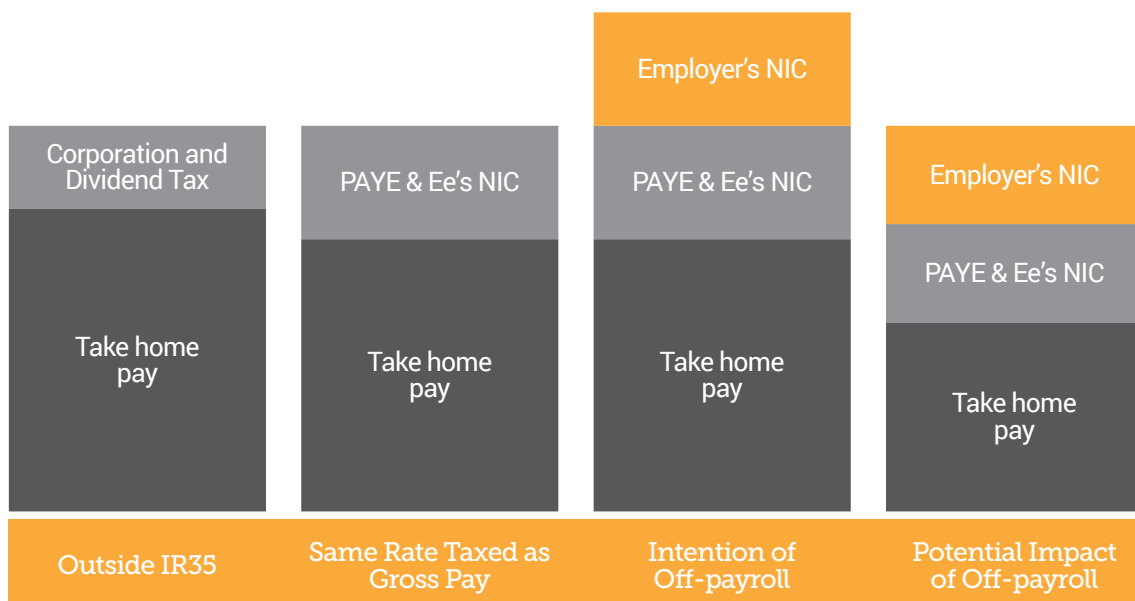
For contractors deemed after assessment to be working ‘inside’ IR35, a contractor can be paid through an umbrella employment solution.

Umbrella companies employ contractors under the terms of a permanent employment contract, meaning that the individual receives all 84 statutory rights and employment benefits while also having the flexibility to work for a series of different end hirers. The umbrella company provides employee benefits such as access to pension schemes, paid leave for holidays, maternity, paternity, sickness, etc. The umbrella company is also responsible for the provision of appropriate insurance. They also undertake all of the necessary administration, such as checking visas, invoicing the agency for any work undertaken, collecting payment, and calculating the amount to be paid to the freelancers, ensuring that appropriate PAYE tax and NICs are paid to HMRC.

When choosing an umbrella employer for your contractor workforce, it is important to engage the services of an accredited company that can demonstrate compliance with industry standards, such as an FCSA Accredited Member, to protect everyone in the supply chain from the worker to the agency, to the end hirer.

The diagram below illustrates in broad terms how take home pay would be arrived at under different models to help you and your clients understand the implications of using the umbrella option (column 4). It’s important to note that if a contractor using a PSC moves to working through a payroll based service, new contracts must be issued, and a new rate agreed. If this is not done, the worker may take the view that the Employers NIC is being unreasonably deducted from the agreed rate. An FCSA Accredited Member will always help you to ensure that workers being paid via PAYE understand the deductions made from their rate, to arrive at their net pay.

Remember, umbrella contractors usually have less take-home pay the PSC contractors, so you may need to offer an increased rate to your PSC contractors when they move to an umbrella to account for the additional employment costs.



How to mitigate supply chain risk

Is your supply chain comprised of reputable and compliant companies?

To mitigate the risk of non-compliance with IR35, as well as having a robust and transparent assessment process, you must review known parties in your supply chain.

To operate a compliant supply chain, end hirers and agencies must identify and/or prevent non-compliant intermediaries from entering the supply chain. The first step towards ensuring supply chain compliance is to risk-assess all of your payroll service providers.

One such way to identify low-risk service providers is to check for accreditation from a recognised industry body, such as the FCSA. Accreditation shows that a service provider has demonstrated that it is operating in accordance with the highest industry compliance standards.

FCSA Accreditation: your readymade supply chain compliance

FCSA accreditation is recognised as the industry's compliance gold standard.

Accreditation is awarded to umbrella employers, contractor accountants (PSC) and self-employed/CIS payroll providers who can demonstrate the highest industry standards.

Every FCSA Accredited Member undergoes a rigorous annual assessment. The FCSA assessment is recognised as the most stringent testing in the industry by independent, regulated assessors and at no cost to your supply chain.

For end hirers and agencies, engaging FCSA accredited payroll service providers provides assurance that your supply chain is robust as it can be. Peace of mind that any FCSA Accredited Member you choose to work with operates to the highest industry standards for your benefit and protection. Reduced financial and reputation risks and increased value to your organisation.

Pre-requisites for all potential applicants

The FCSA accreditation assessment process is not a simple 'tick-box' exercise. Before any new applicant progresses to the assessment stage, they are required to meet our stringent pre-requisites criteria. This is designed to assess the applicants' business operations in practice, not just in theory. It includes an independent Fit and Proper test of both the applicant company and its directors.



The assessment process

In order to achieve FCSA accreditation, applicants are independently audited against our published standards. The process requires applicants to provide documentary evidence of how they adhere to each and every standard. In addition to the paperwork element, assessors conduct in-depth site visits to the applicant's business to interview their staff, test scenarios, undertake random audits, listen to on-boarding calls and ensure that all policies and procedures are being implemented in practice.

FCSA Codes of Compliance

The FCSA operates a best practice Codes of Compliance designed to ensure that its Accredited Members provide services, advice, and employment to the highest level of professional and ethical standards in the UK.

The FCSA Codes provide complete peace of mind to agencies and end hirers when selecting umbrella employers, contractor accountants (PSC), and self-employed CIS payroll providers for their preferred supplier list for the following reasons:

- The FCSA Codes of Compliance has been developed by Ernst & Young, in consultation with HMRC, and is available to the public on the FCSA website.
- All FCSA Accredited Members are tested annually against the FCSA Codes of Compliance by independent, carefully selected assessors.
- The assessors are top-tier regulated accountants and solicitors bound by their own professional standards and code of conduct and are independent of the FCSA.
- The assessors are experts in the sector and are carefully selected by the FCSA.
- The FCSA Codes of Compliance is continually updated to reflect current legislation.
- Non-compliance by FCSA Accredited Members results in the suspension or termination of FCSA Accredited Membership.

Why choose FCSA Accredited Members?

- Low risk, trusted, independently vetted supply chain partners.
- Demonstrably the highest compliance standards within the industry.
- Complete transparency with HMRC.
- Proven track record in the provision of high-quality services and support to workers.
- Access to the top industry experts and advisors.
- The only compliance standard recognised and endorsed by all of the UK's leading recruitment bodies, including REC, APSCo, and TEAM.

Find an Accredited Member

If you are looking for a compliant and transparent service provider for your contractor workforce, check they're FCSA Accredited.

You will find a list of all FCSA Accredited Members on your website, visit www.fcsa.org.uk/members

About FCSA

The Freelancer & Contractor Services Association (FCSA) is the UK's leading membership body dedicated to raising standards and promoting supply chain compliance for the temporary labour market. Our purpose is to safeguard the long-term future of the professional freelance sector for the benefit of the UK economy by:

- Setting and raising standards for service providers who support professional contractors
- Promoting compliance in order to protect professional contractors
- Influencing and lobbying to ensure that members' needs are represented to policymakers
- Collaborating through partnerships with like-minded organisations

FCSA's primary role is to raise standards and promote compliance and through our Accreditation, we encourage self-regulation in our sector in supporting contractors to meet their tax and legal obligations. FCSA Accredited Members are tested against our Codes of Compliance annually and must pass in order to retain their accreditation.

Our standards are the most stringent and comprehensive in the industry, as detailed in our Codes of Compliance, which is published and freely available on our website.

Importantly, no FCSA Accredited Member is allowed to operate Offshore Schemes, Loan Schemes, Trusts, Managed Services Companies Schemes, Pay-day-by-Pay models, or similar.

Any contractor, recruitment agency, or end-hirer choosing to work with an FCSA Accredited Member is assured that the member operates at the highest industry standards for the benefit and protection of the supply chain.



This guide was produced in collaboration
with FCSA Accredited Member

