

IR35 Reforms in the Public Sector

A guide for agencies and end hirers

**IR35**



Background – what is IR35?

Intermediaries Legislation, or IR35, became law in April 2000. It was intended to tackle concerns about businesses hiring individuals as consultants rather than employees. The particular example given was someone leaving work as an employee on a Friday, only to return the following Monday to do exactly the same job as a consultant. In this scenario the business reduces their statutory responsibilities (as employment law is no longer applicable), whilst also reducing their Employers' National Insurance Contributions (NIC) bill. The individual loses their statutory rights but gains flexibility and further tax planning benefits.

The premise of IR35 is that any individual caught by the legislation (also known as being “inside IR35”) must pay tax and NICs on a deemed payment broadly equivalent to the tax and NICs that an employee would pay.

IR35 legislation requires evidence to be considered covering several factors, with the actual working practices often being more important than the contractual agreement. Considerations include, but are not limited to:

- **Control** – to what extent the individual is told how to undertake the work
- **Substitution** – whether the individual can send someone else to deliver the same outcome
- **Mutuality of Obligation** – for the hirer to provide work and the individual complete it
- **Financial risk** – whether the individual is in business on their own account
- **Part and parcel of the hiring firm** – the extent to which the individual is treated like an employee

All of the evidence is considered, an overview taken, and if the balance of probabilities is that the worker is more akin to an employee than being in business in their own right then IR35 applies. The individual is assessed as being inside, or caught by, IR35 and must pay tax and NICs to HMRC based on the income for that assignment.

Alongside IR35 legislation there is 20 years of case law which informs the IR35 status outcome.

The legislation originally intended for the hiring business to be responsible for the IR35 status of anyone that they engage, but there was concern that it would disrupt the flexible workforce – see below quote from the then Paymaster General, Dawn Primarolo. As they are in business on their own account, IR35 liability has always been the responsibility of the individual being engaged to carry out their services to the hiring firm.

“I am determined that nobody should be able to avoid paying their fair share of tax and NICs just because of the way that they structure their relationship. But we have recognised that any action must do no unnecessary damage to the flexible labour market.”

Dawn Primarolo, Paymaster General, September 1999



What changes have occurred?

- **Effective since 6 April 2017**
- **Public sector bodies** are responsible for determining IR35 status.
- **Public sector bodies** must communicate their IR35 determination to the supply chain, i.e. the company that they contract with to supply the labour.
- **“Fee-payer”** is the entity contractually responsible for paying the intermediary (usually a personal service company) of the individual doing the work.
- **The fee-payer** is legally responsible for ensuring correct tax and NICs are paid when paying the individual contractor’s personal service company.

Unaffected by the public sector changes:

- Unincorporated self-employed (sole-traders).
- Agency workers.
- Umbrella employees.
- Outsourced services where there is a break in the labour supply chain:
 - E.g. building a hospital where the required workforce is supplied to the privately owned construction firm and not to the public sector body.
 - Be careful and **seek legal advice** on the detail of the contractual supply chain.

Who are the public sector?

The legislation defines the public sector as any organisation caught by the Freedom of Information Acts (2000 England, and 2002 Scotland). This includes:

- NHS, police, fire, MoD, TfL
- Local authorities
- Devolved administrations
- Education
- BBC, Channel 4
- Bank of England

The definition also includes any organisation that is wholly owned by a public sector body. Clients ought to know if they are caught by the FOI Act definition. It is worth noting that FOI Acts can be varied and so should be monitored for any changes.

Liability in more detail: public sector hirers

- Public sector hirers are required to communicate their IR35 determination to the agency closest to them in the supply chain **either before the contract is agreed, or when the services start** (whichever is the latest).
- The agency can raise written questions regarding the hirer's decision, and the hirer has 45 days from the date of receiving the worker's disagreement to respond. During that time the fee-payer should continue to apply the rules in line with the client's original determination.
- The hirer must take reasonable care in determining IR35 status.
- If the hirer fails in the above duties they become the fee-payer, with the obligation to operate PAYE and NICs for engagements inside IR35.

Liability in more detail: fee-payers

- The fee-payer is liable for processing PAYE and NICs for contractors where the assignment is deemed inside IR35.
- The fee-payer is required to pay any other employment costs, e.g. the Apprenticeship Levy which is due on payrolls in excess of £3m.
- The fee-payer might be several stages further down the supply chain from the hirer, so the IR35 status needs to be communicated throughout (although there is no obligation).
- If hirers incorrectly determine a contractor as being outside IR35, there will be unpaid tax and NI which the fee-payer might be liable for. (NB: the fee-payer could be the hirer if they fail to meet their duties as explained above.)
- If you are the fee-payer and you disagree with the hirer's IR35 determination, you could be liable for unpaid tax and NICs.

Liability in more detail: contractors

- Contractors are required to notify the fee-payer whether their intermediary (personal service company) meets the conditions of liability for IR35 to apply. e.g., whether the individual owns more than 5% of their personal service company.
- If contractors don't inform the fee-payer, conditions of liability will be assumed to be met and the fee-payer will need to operate PAYE and NICs if the engagement is within IR35.
- There is no transfer of liability to the contractor. However, it is in their interest to share information otherwise they risk unnecessary PAYE and NICs being processed.



How are payments processed?

Here's how it works in practice:

- The contractor issues their invoice at the agreed rate for the work undertaken.
- The fee-payer pays the VAT element through their accounts payable.
- Consider whether any tax-deductible expenses are applicable (optional).
- The remaining invoice balance goes to payroll to be dealt with as gross pay:
 - From which PAYE and employee NICs needs to be deducted.
 - Employers NICs will be an additional cost to be paid (not deducted from the invoice).
 - Payroll will need to collect personal data and issue payslips, P45s, P60s etc.
- Payments and reconciliations need to be undertaken by different departments (accounts payable and payroll) in order to pay the invoice.
- **Employers NICs must be factored in somewhere within the supply chain costs:**
 - Legally these cannot be automatically deducted from the assignment rate, instead a new rate must be agreed.
- Other payroll costs such as the Apprenticeship Levy should also be planned for.

Financial complexities for contractors

- Processing deemed payments throughout the year means paying tax much earlier than the corporate cycle, which allows up to nine months after the tax year ends.
- Deemed payment calculations made throughout the year are inaccurate as there is no opportunity to take account of capital expenditure, pension contributions, etc.
- Therefore, in addition to the payments made throughout the year, the contractor still needs to process an annual calculation to reconcile their true position.

CEST: HMRC's Employment Status Service

- HMRC has developed an online tool to support hirers in determining the IR35 status: <https://www.gov.uk/guidance/check-employment-status-for-tax>
- Using HMRC's CEST tool is not obligatory, though they will guarantee the outcome generated by their service providing correct information is inputted.
- There are five sections covering: personal service, control, financial risk, business structure and whether someone is "part and parcel" of the hiring business.
- If a determination is clear from answers given to early questions, then it might not be necessary to complete all five sections.
- CEST has a "save and retrieve" function enabling information to be added over seven days.
- CEST does not retain records beyond the seven day "save and retrieve" function.
- There is a "print and sign" function enabling users to retain a copy of the determination and answers supplied to generate that outcome. **It is highly recommend that you do this.**
- There is no appeals process to dispute the determination generated by CEST.



What are the options?

- Determine likely IR35 status in advance of filling roles:
 - Work out the cost implications of both scenarios (inside and outside IR35), and consider the impact on assignment rates.
 - Pay contractors through their personal service companies, either payroll or gross depending on final IR35 determination.
- Consider an employed solution such as a fixed-term contract with hirer, or umbrella:
 - Ensure the impact of any additional costs are factored in.
 - It is essential to ensure the contractor has clarity regarding their gross pay rate.
- Consider an intermediary to process payments:
 - The final legislation (published 20/03/17) includes an MSC legislation carve out.
 - Therefore, the payment intermediary can be the same accountancy firm that advises the personal service company, but care is needed.
 - This is only applicable when PAYE and NICs are operated.
 - In this instance, the intermediary does not become an MSC provider.
 - As it is outside the scope of MSC legislation, there is no debt transfer risk.
 - Should the intermediary process gross payments to the personal service company, MSC is not automatically dis-applied and needs to be considered.
 - It is essential to obtain professional advice for your specific circumstances.
- Agency payroll; again ensure any additional costs incurred (such as employers NICs and the Apprenticeship Levy) are properly considered and factored in.

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.

