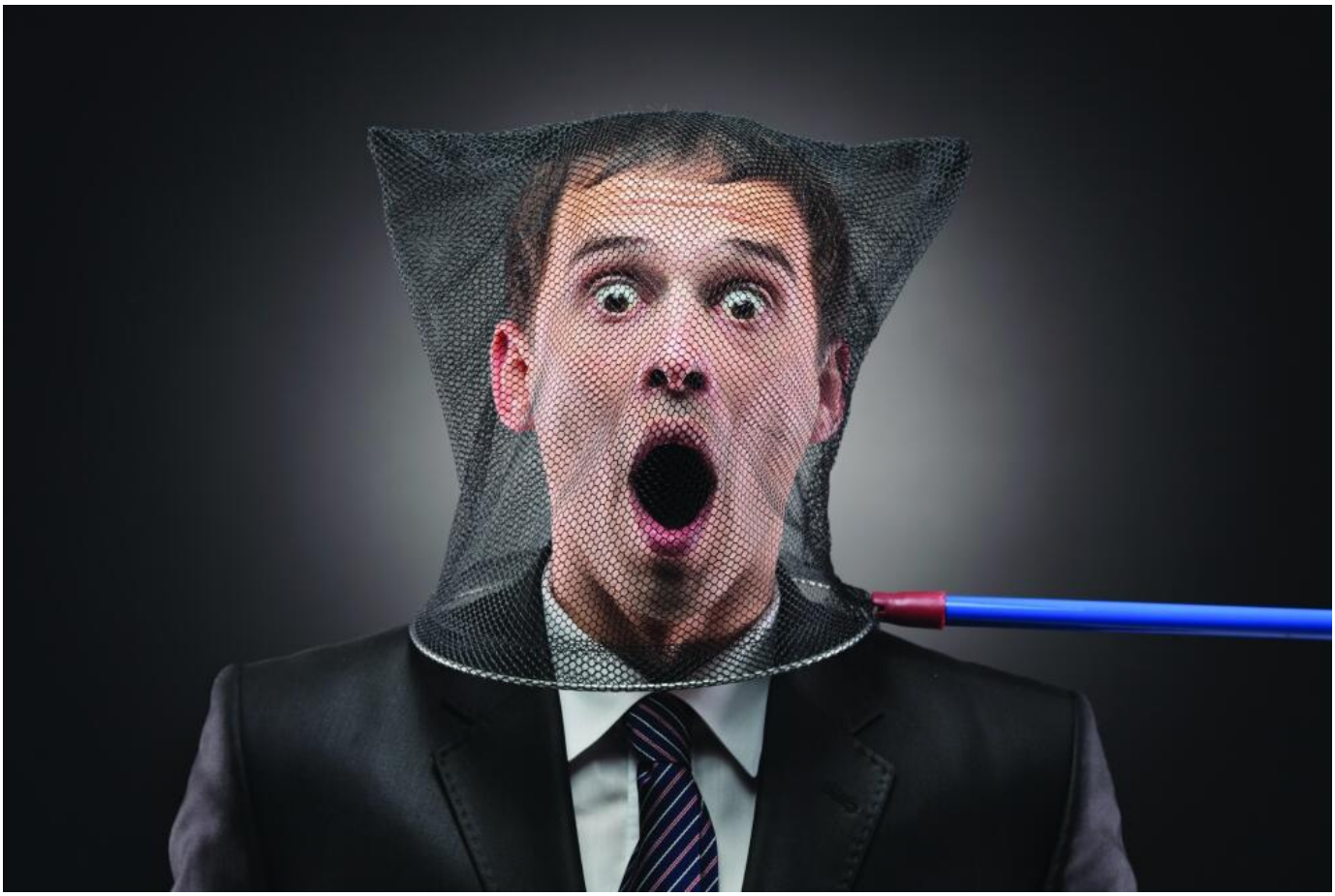
Will you be caught by IR35?

Employment Tax



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Edmund Paul considers the steps which businesses should take to prepare for the deferred IR35 legislation to be introduced on 6 April 2021

Key Points

What is the issue?

The IR35 legislation is coming into effect from 6 April 2021. Businesses should once again consider the steps they should take to prepare for the changes.

What does it mean for me?

Based on our experience of the April 2020 implementation, businesses that failed to prepare for the changes experienced higher costs and disruption. Businesses should take steps now to prepare for the changes, including review records, correspond with contractors and update engagement contracts.

What can I take away?

The preparations made for the April 2020 implementation should be revisited to understand whether the contractor population has changed, assessments made remain valid and if processes can be enhanced.

Due to the ongoing coronavirus pandemic, it was decided that the implementation date for the IR35 legislation would be postponed until 6 April 2021. Many businesses had already undertaken significant preparation for the arrival of this legislation, which was often fraught with difficulty.

Businesses are now once again considering the steps they should take to prepare for April 2021. This article looks at some of the practical implementati on challenges that we have seen and the ways in which businesses have sought solutions.

This article focuses on personal service companies (PSC), as it is the most common intermediary through which businesses engage with contractors.

Contractors caught by IR35

In order for a worker to be caught by the IR35 legislation, the worker would need to own a material interest in the PSC through which they provide their services.
The draft legislation defines a ‘material interest’ as having:

- beneficial ownership of, or the ability to control, more than 5% of the ordinary share capital of the company;
- an entitlement to receive more than 5% of any distributi ons that may be made by the company; or
- an entitlement to receive more than 5% of the assets on winding up.

However, there can be difficulties in identifying whether a worker has a ‘material interest’ in an intermediary.

Practical complexities in identifying ownership structures

Publicly available information on corporate ownership structures is scarce. The most accessible data can be found within Companies' House.

Companies' House can confirm whether an individual owns over 50% in the corporate entity. However, it will not identify scenarios where an individual owns between 5% and 50% of the intermediary, nor if the contractor is entitled to distributions or assets on winding up. Therefore, its use in determining which contractors fall within the scope of the IR35 legislation is limited.

Given this, many engagers chose to reach out to contractors when trying to identify their impacted populations. Approaches varied, with some businesses requesting detailed information on ownership structures, whereas others relied on representations from contractors as to whether the legislation applied. This was often coupled with contractual indemnities to ensure accurate information was supplied.

When solely relying on information provided by contractors, some clients found contractors were not forthcoming in providing data. Alternatively, possibly because there was a desire to continue arrangements as is, only favourable datasets were provided.

The requirement to determine whether the IR35 legislation applies falls on end clients. As such, HMRC would seek any underpaid income tax and NIC in the first instance from the engaging entity. To recover this by using a contractual indemnity could be complex, especially as contractors may simply not have the money available to settle any claim.

There may also be a delay between any assessment being raised by HMRC and the business reclaiming the amounts under the indemnity.

Next steps

Businesses should ensure that there is sufficient time to review records, correspond with contractors and update engagement contracts (where required). Experience from last year shows us that businesses which took action well in advance were best prepared for implementation and expecting less disruption.

There is no one size fits all approach; each business should consider the most efficient and effective method to review its contractor population. The most appropriate approach will depend on the quality of the internal data held on contractors, the resources available to undertake such an exercise, and the relationship between the business and contractor.

Where a business is relying on representati ons made by contractors, ensure that there are sufficiently robust processes to validate the informati on provided. This can range from a sense check of the data against Companies' House to requesting detailed backup documentation from the contractor.

Identifying the 'end client'

Entities which benefit from the personal service of a contractor (i.e. end clients) will be responsible for determining the contractor's employment status and preparing the status determinati on statement (SDS). Where an entity does not comply with its obligations under the IR35 legislation, the liability to any underpaid income tax and NIC (as well as interest and penalties) would rest with the non-compliant end client.

Whilst in most cases it will be clear who the end client will be, for outsourced services the reporting obligations may not be clear. Additional complexities can arise where there is a long chain of intermediaries, such as multiple agencies.

Typically, an outsourced service envisages a product being received. Where a service is received and that service primarily relates to the provision of specific individuals, potentially also naming them, then there is a risk that it would not be an 'outsourced service'. Arrangements where there is a mixed service contract in place, or the agency has a bespoke payment arrangement (e.g. commission based), should be carefully considered.

Methods of identifying the end client where an outsourced service is provided

As a starting point, the contract should be considered to understand the services being provided. A true outsourced service generally specifies a fixed scope of services with a fixed fee on completion of that deliverable. On the flip side, a personal service contract would provide an individual for an agreed daily rate.

Businesses should consider whether the contractor’s services are similar to those provided by its employees. Where this is the case, there is heightened risk that the service is not an outsourced service.

HMRC suggests that where the service provided by the worker aligns closely with the nature of a business, this indicates that an outsourced service is not being provided.

Next steps

Businesses should reach out to suppliers to agree who will be undertaking employment status assessments, as this will help to avoid disputes on how different parties interpret their obligations.

Consideration should be given to engagements with small companies (as defined by Companies Act 2006), as they fall outside the scope of the changes. The rationale for the decisions taken should be documented and retained in the event of a HMRC enquiry.
Processes should also be in place to monitor the evolvement of engagements. Whilst an engagement may initially be outsourced, with the passage of time they can evolve and become one of personal service. Periodic reviews are recommended to ensure that the correct entity undertakes the employment status assessment.

Many clients have found that current contractual wording does not reflect the true nature of engagements. As part of the preparation for the upcoming changes, businesses should consider refreshing engagement terms to ensure they match the engagement realities.

Minimising business disruption following the assessment process

Many contractors consider themselves to be self-employed and prefer to receive their remuneration without income tax or NIC deductions.

However, there will be instances where the engager disagrees and considers the relationship to be one of employment under the IR35 legislation. Our experience is that this will not be welcomed by most contractors, given the perceived risk of a retrospective HMRC challenge into historic self-assessment submissions, as well as a reduction in ‘take home’ pay.

For the April 2020 implementations, a significant number of challenges were made against employment status determinations. Often, this was done by contractors obtaining independent reviews into their employment status or emphasising aspects of the engagement that indicated they were working on a self-employed basis. Contractors also completed HMRC's Check of Employment Status Tool (CEST) and, to the extent that these produced a different result, suggested that employers did not take reasonable care when making assessments.

Dispute resolutions were found to be time consuming. The draft legislation states that end clients are only required to consider submissions within 45 days of receipt and provide a statement either confirming the original decision (with supporting reasons) or amend the original determination. However, the reality was that there were protracted rounds of correspondence with workers before the matter was resolved. Where the individuals worked for clients of the end user, these complaints could also be escalated to client contacts causing relationship disruption.

In some cases, contractors who were deemed employees under IR35 chose to depart engagements where there was no corresponding day rate increase. This created a struggle to backfill niche roles.

Methods of reducing the business disruption arising from the changes

From our experience, clear communications significantly reduce the risk of contractor challenge. The most successful businesses made contractors aware of the upcoming changes; the process through which the business would identify and assess its contractor population; and the timescales in which key decisions would need to be made. In the main, these would be centrally managed with key individuals briefed on how to handle contractor conversations and escalate concerns.

Businesses also considered which workers were business critical and, for these workers, undertook bespoke conversations. Many engagers identified replacement candidates where engagements relied on niche skillsets well in advance of the statutory deadlines. This meant that the business was in position to onboard a replacement immediately.
There was also a perception of bias, given that the dispute resolution process is 'client led'. To avoid this perception, many engagers had different teams who dealt with disputes or, where an external tool was utilised, generated a new employment

status determination statement based on the additional information provided.

As part of the wider IR35 project, businesses considered different engagement terms for contractors, including whether it was more appropriate to engage as employees considering the pros and cons.

Next steps

Given the recent Covid-19 pandemic and the limited Government support for PSCs, contractors may be more open to different engagement terms. Where this is not the case, businesses should consider whether any assessments made prior to April 2020 remain accurate, and if not, undertake new assessments.

A communication plan should be established for when assessment results are disseminated and deadlines for accepting new engagement terms.

If the business is considering using a different method of assessing the employment status of its contractor populations, then a comparison of the new assessment method versus the old method should be undertaken. Where this results in significantly different assessments, these should be communicated to contractors at the earliest opportunity to manage their expectations.

Given the cash flow constraints arising from Covid-19, businesses should be considering the commercial impact in even more detail, including whether any increases in engagement costs can be passed onto third parties.

Other points for consideration
Length of supply chains

The IR35 legislation requires businesses to review their supply chains to understand whether contractors have been utilised by suppliers. If so, there may then be a requirement to assess these workers' employment status.

Businesses need to undertake a due diligence of their supply chains. Agencies are generally aware of their requirements and proactively provide the required data, though a small minority of suppliers may be reluctant to divulge information on their downstream supply chains. This can cause delays in identifying the population requiring assessment.

There are transfer of liability provisions within the new legislation. This means that any underpaid income tax or NIC can transfer to the first agency in the contractual chain and, if not collected from this entity, then to the end client itself. This has meant that there is greater need to fully understand the supply chain and ensure that sufficient protections are contained within contracts. In addition, many clients have sought to understand the potential exposures for non-compliance downstream, with a view to ensuring suitably robust contractual terms.

The use of umbrella companies

To reduce the administrative burden of undertaking employment status assessments, some businesses sought to remove PSCs from contractual chains and engage workers via umbrella companies. Whilst this approach means that employment status assessments are not required, operating through an umbrella company may not be acceptable to the contractor and costs could increase.

Caution should be taken when engaging workers through umbrella companies that are not registered in the UK or without having undertaken appropriate due diligence. HMRC is increasingly aware of non-compliant umbrella companies (see Spotlight 55) and there is a risk that the income tax and NIC liability is passed up the contractual chain.

Interaction with VAT

Where a contractor raises an invoice, this would contain the agreed fee and VAT (to the extent the supply is subject to VAT). Whilst the amount paid in respect of the workers' services would need to be subject to PAYE (alongside the PAYE reporting obligations), the VAT element of the invoice would still be payable in full.

Processes should be in place to ensure that invoices are appropriately flagged and that the correct amounts (i.e. post income tax and NIC) are paid to the worker, the VAT element is paid in full and is also captured in relevant VAT returns.

Entitlement to employment rights

The government has specifically stated that changes to the IR35 legislation do not automatically entitle workers to employment rights. However, given that contractors will be suffering PAYE deductions and are considered to be employees for tax purposes, there is a risk that they will ask for corresponding employment rights (e.g. holiday pay, sick pay etc.).