

Source's guide to IR35.



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What is IR35?

IR35 is legislation that was introduced nearly 20 years ago, to prevent 'disguised employment' tax avoidance.

The aim of this legislation is to capture individuals operating through a Personal Services Company (PSC), who try and avoid income taxes and manipulate National Insurance Contributions (NICs), where for all intents and purposes they would be an employee of the client.

The Off-Payroll Working legislation for the private sector comes into effect in April 2021.

This will only effect medium & large private sector organisations with a UK connection, so "small" companies are exempt - the definition of which is based on the Companies Act 2006 definitions. Under section 382 of Companies Act 2006, a company qualifies as "small" if two of the following conditions apply:

- Annual turnover is not more than £10.2 million
- Balance sheet total is not more than £5.1 million
- Number of employees is not more than 50 employees

Where the medium and large-sized private sector client is based wholly overseas and has no UK connection (in the form of being a UK registered business or having a permanent UK based establishment), the worker's limited company (PSC) will remain responsible for deciding the contractor's employment status and whether IR35 applies. In March 2020, Covid-19 delayed IR35 by one year to April 2021. IR35 was passed into Primary Legislation in July 2020. It will not be delayed or altered any further. It will come into effect in April 2021.

This guide is designed to give you the key detail of this rather complex legislation to enable you to get your business ready for April 2021.

The Key Changes

The reality is the underlying law will remain the same. However, there are some significant changes that must be understood to ensure compliance with the new rules from April 2021.

The new rules mean that it becomes the client's responsibility to assess a contractor's IR35 status, and therefore the responsibility no longer resides with the contractor. The client has obligations to ensure that they assess each assignment individually, articulate the reason behind the decision, and avoid making blanket decisions whilst taking 'reasonable care'.

Someone is deemed as 'outside IR35' if they are a genuine independent contractor and their PSC can be paid gross, without tax deductions or NICs by the client or the staffing agency.

Significant penalties in the form of unpaid tax could be charged to the client if the following requirements of this legislation are not met:

- The client needs to communicate the outcome of the Status Determination throughout the supply chain, and directly to the contractor.
- The Status Determination has been correctly carried out in line with legislative requirements.
- The supply chain must operate according to the client's instruction.

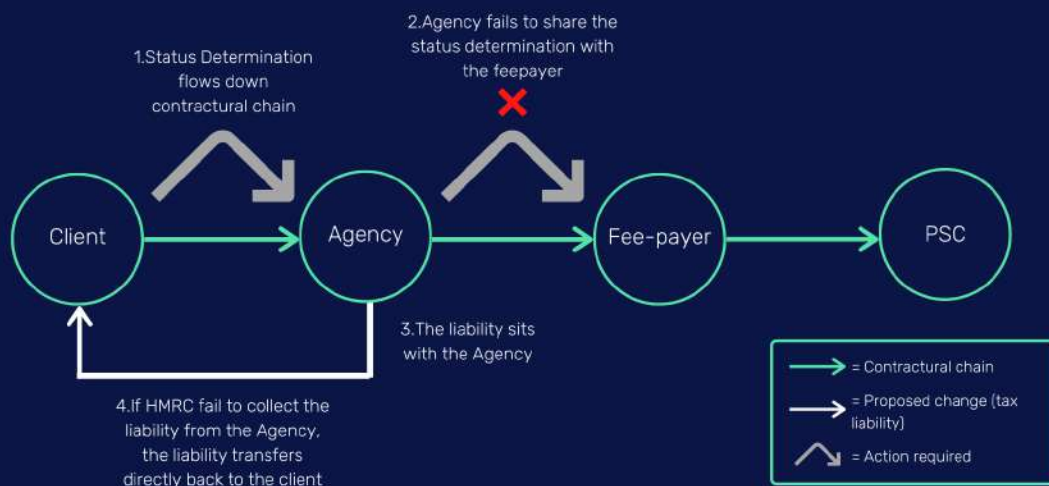
The responsibility for accounting for tax and NICs will rest with the fee payer (the organisation responsible for paying the contractor).

The contractor has the legal right to appeal the Status Determination outcome, and a response from the end client must be made within 45 days.

Where does the liability sit?

The roll out to the private sector will see HMRC having a stronger ability to recover monies owed - because the client often could be largest company in the supply chain, liability could lead back to the client. This is why supply chain compliance is crucial.

This diagram shows the transfer of liability across the labour supply chain:



Importantly if the client does not take "reasonable care" when making a Status Determination, the Status Determination Statement will not be valid and the client will ultimately be liable as the deemed fee-payer.

The 4 Key Tests

There are 4 key tests that can be used to identify if a contractor is inside or outside of IR35.

1

Mutuality of Obligation

Does the contractor have to accept the work and does the worker expect to be given work on a constant basis? If the answer is yes, then there is a strong likelihood that there is mutuality of obligation and will fall inside IR35.

2

Substitution

In an employment relationship, the employee would not be able to send in a substitute to carry out their services. For a contractor to genuinely be operating outside of IR35 there should be a 'right of substitution' option, not only defined within the contract, but also must be a genuine ability within the actual working practices. If a contractor needed to provide a substitute, then the client must accept the substitute.

3

Supervision and Control

This factor revolves around the extent to which a client controls where, when and how an individual performs their work. In most cases where professional services are provided, it is important that a contractor can demonstrate a certain amount of autonomy in the way they undertake a project. Conversely, employees are typically under the direct supervision and control of their employers, however the truly self-employed will have more influence over how they complete the work they have been hired to do. Therefore, for a contractor to successfully demonstrate that they are not under the direct supervision and control of the client, both the written contract and working practices must show that they have no influence over how the contractor performs their services, nor the manner in which they are performed.

4

Part and Parcel

If contractors are embedded into the company structure, this points more towards employment than self-employment and therefore likely to be inside IR35.



What do you need to do?

A key learn from the Public Sector roll out, is that many organisations took a blanket approach and put genuine contractors as inside IR35 and placed them on PAYE contracts. This resulted in increased costs for them and contractors migrating to the private sector.

With the latest changes, contractors won't be able to move sectors, but with an appeal process in place it will create additional admin burden for clients.

Blanket approaches are also deemed as not taking "reasonable care" by the client and therefore resulting in the client becoming the fee-payer and liable for any potential unpaid taxes.

There is a 4 stage process to help you achieve compliance and minimise risks to be ready for April 2021, with a robust process for engaging contractors moving forwards.

Stage

1

Identify

The initial stage of the process is gathering all the hard data which will enable you to understand the operating structures and the Off-Payroll status of everyone within your contract population.

Stage

2

Evaluate

This stage enables you to pinpoint existing risks within your current supply chain and the associated financial implications.

Stage

3

Plan

This stage enables you to decide the engagement styles you will allow, complete the legal and compliance policies, coupled with enabling you to finalise the budget and rates for the contract roles within your business.

Stage

4

Implement

At this point, you will have a clear plan, knowing what to do and how you're going to do it, so you need to implement the plan, ensuring supply chain compliance, alignment and a process for the ongoing management of your contract workforce.



Engaging with new contractors post April 2021

Once you have completed your audit of your contractor population (stage 3), you will then understand what engagement options are available to you (stage 4).

Personal Service Company (PSC):

A proportion of the contract population, will remain outside IR35 and therefore PSCs will be a viable option.

Pay As You Earn (PAYE):

This is where you would convert a contractor to become a PAYE engaged individual. The risk in doing this is that unless you give an uplift in the pay rate the contractor may terminate the contract.

Deemed:

This is where a contractor is engaged through their PSC but for this assignment it is "deemed" inside IR35 and taxes need to be deducted. This is helpful for contractors who flip between inside and outside IR35 contracts, but this is considered to be complicated and expensive to calculate. It also carries too much risk for it to be a viable option, with little uptake seen in the public sector.

Umbrella:

This is an attractive option for any contractors who are caught inside IR35. The umbrella company would withhold all taxes, but also offer PAYE benefits to the contractor (healthcare, pension and loyalty schemes).

Statement of Work:

This is engaging with a company to deliver a pre-determined and well defined piece of work, for a fixed price, but not naming any specific individual which is key for the ongoing management of the project and must align to the terms specified.



Engaging with new contractors post April 2021

We recommend making a collaborative assessment to ensure all parties are involved and therefore will reduce any appeal process risk that could result if you do not involve the contractor in the decision making process. Therefore, we recommend the following as the best process to engage with contractors when using your recruitment partner.

- For each role within your business, establish a 'baseline assessment'
- Brief your recruitment partner with the 'baseline assessment'
- Your recruitment partner secures you the best and most appropriate talent
- Do a full assessment by inviting the contractor to complete their part - 'contractors details'
- Issue a Status Determination Statement before contractors start

Are there risks of directly engaging with contractors?

In preparation for April 2021, many clients are reviewing their engagement options. It is important that clients are aware of the risks of engaging with Off-Payroll workers directly, as opposed to working with a recruitment agency to supply these workers. With the upcoming changes, engaging directly with those assessed as within IR35, only heightens the risks.

Below details some key areas for consideration to help you with your planning:

Direct Engagement with contractors:

Dave Chaplin (MD of IR35 Shield) & Crawford Temple (MD of Professional Passport) provide the following commentary about directly engaging with contractors. "Engaging with contractors directly comes with increased risks, especially where they are self-employed. Where contractors are paying PAYE levels of tax, their view is that they should have all the benefits that come with employment. We have seen in the press, high profile cases that have not gone in the client's favour. Directly engaging with contractors is a high-risk strategy. Protection from this can be found when a recruitment business is placed in between a contractor and the client."

At Source, we offer lower margins for handling these contractors on your behalf. We can also offer longer payment terms than contractors who need to satisfy their own cashflow needs.

This will in turn reduce the admin burden of processing payments for a workforce of direct contractors and not forgetting managing the associated compliance such as Right to Work, ensuring correct levels of insurance are in place and stay in place and putting checks in place for Anti Money Laundering etc.



The risks of engaging with contractors directly

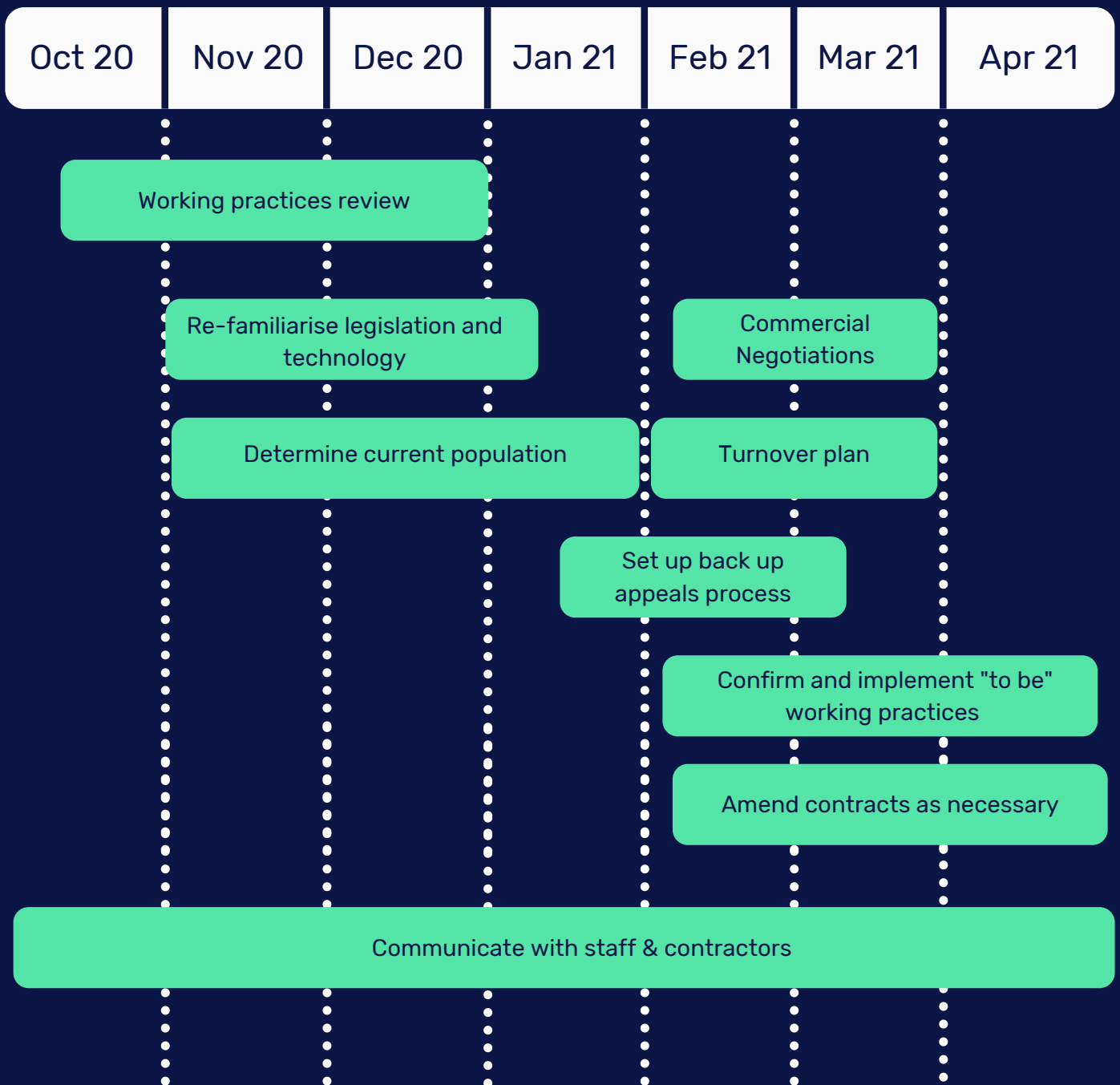
Brookson Legal are IR35 specialists and have been advising on IR35 since it was introduced. Brookson is the only law firm regulated by the Solicitors Authority that focuses on IR35 matters. They have identified the following risks of engaging with workers directly and how legislation can affect clients. Here are some of the risks they have identified:

- **Criminal Finance Act (CFA):** Clients are now liable for the actions of all contract workers who aren't paying the correct amount of tax. This could lead to the hirer facing financial penalties and criminal convictions.
- **Intermediaries Legislation:** Hirers are responsible for ensuring that contractors are being paid by intermediaries, such as umbrella companies. They also need to ensure that the correct tax is applied, and processes are followed, failure to do so will result in financial penalties and risk of convictions.
- **Transfer of Debt:** This relates to clients becoming liable for debt responsibility if they are found to have engaged with sole traders, unincorporated businesses or MSCs.
- **Managed Service Company Legislation (MSC):** If a hirer engages directly with a contractor and HMRC find this contractor to be using a MSC, they are required to pay income tax, and NI contributions, as if they were employees. Transfer of debt liabilities, including back dated income tax and NI apply to hirers who engage with MSCs.
- **Agency Workers Regulations (AWR):** These are designed to tackle discrimination against contract workers including low pay and working conditions. The regulations give temporary workers a number of rights. Hirers are responsible for understanding the workers rights against AWR and take the necessary action to avoid being penalised.

The above clearly highlights the benefits of engaging with a recruitment business. However, it is essential that you ensure you only engage with recruitment businesses that place compliance at the heart of their organisation to minimise the risk to your business.

Not doing your due diligence with your recruitment partners and their suppliers can see significant penalties in the form of unpaid tax charged to you the client. Source is well versed in compliance and can assist you with the due diligence you should be doing with your recruitment partners.

Timeline of Change





Why are Source a trusted supplier?

Ahead of the changes, it is essential that going forward you are only using compliant and trusted suppliers.

Source have always taken compliance very seriously right from when we opened our doors some 30 years ago. We have always ensured compliance with all key legislation that our industry requires such as the Employment Agencies Act, the Equality Act and GDPR to name a few.

For us, IR35 is just another key piece of legislation that needs to be adhered to and in particular, this legislation requires us to work extremely closely with and in support of our clients.

To enable us to work collaboratively with our clients and help navigate and support them through these changes, we invest hugely in our business infrastructure, provide all of our team with industry-leading training. We only engage with fully compliant and insured candidates and suppliers, to minimise risk for both our clients and our candidates.

We hope this booklet helps you with your insight and planning and we would welcome the opportunity to offer further support to you and your business.

Please contact me at ir35@wearesource.co.uk to arrange a meeting.

Kindest regards

A handwritten signature in white ink that reads "Annika de Friend". The signature is written in a cursive, flowing style.

Annika de Friend



Thank you



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