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Orange Genie

Accountancy
Contractor and Small Business Specialists

A Contractor's
Guide to IR35

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IR35 – what is it all about?

Introduced in 2000, IR35 determines a contractor's employment status for the purposes of Tax and NI. With Public Sector changes in 2017 and now Off Payroll in the Private Sector from 2021, it's not surprising Contractors quite often don't know where to start.

In this guide we will explain everything you need to know in order to navigate the legislation successfully.

IR35: The Backstory

In the late 1990's, favourable tax rates for small businesses led to a boom in individuals looking to provide their services through their own Limited companies. The problem was that many of these individuals offered their services to end clients where they had previously been employed and they were in effect still undertaking the same role. These contractors became known as **"disguised employees"**.

Contractors operating through a Limited company are able to enjoy a level of tax efficiency, by paying themselves small salaries and dividends. End clients engaging contractors in this way, do not pay employers national insurance, or any other costs associated with employment.

The growth in the number of contractors operating this way was enormous and whilst many were legitimate businesses, HMRC perceived there to be much abuse. IR35 was introduced to combat this situation.



The Story So Far

2000 | IR35 Introduced

2007 | MSC Introduced to Combat contractors not connected with the business taking advantage of dividend rules

2011 | IR35 Forum established
Business Entity Tests Introduced

2015 | Business Entity Tests scrapped

2017 | Public Sector Reform
Removal of Travel and Subsistence when "Inside" IR35
CEST Introduced

2019 | Private sector consultation
CEST updated

2021 | Private Sector Reform

Why Does IR35 Matter?

Your IR35 status determines how you pay tax on the income you take from your Limited company.

If your assignment is deemed to be "Outside" IR35, the contract has been assessed as being a genuine business to business agreement. You are able to manage your own tax planning; you can take a combination of salary and dividends which ultimately affects your take-home pay.

If you are deemed to be "Inside" IR35 then your relationship with the end client is deemed to be one of "employment" and you are viewed as a "disguised employee". In this scenario you have to pay PAYE and NIC's on your invoice value but you are not protected by any employment rights.

Being found "inside" also means you cannot claim your Travel and Subsistence expenses. You may or may not be able to claim a 5% allowance for the cost of running your company, depending on the size of your end client.



Who Does IR35 Apply To?

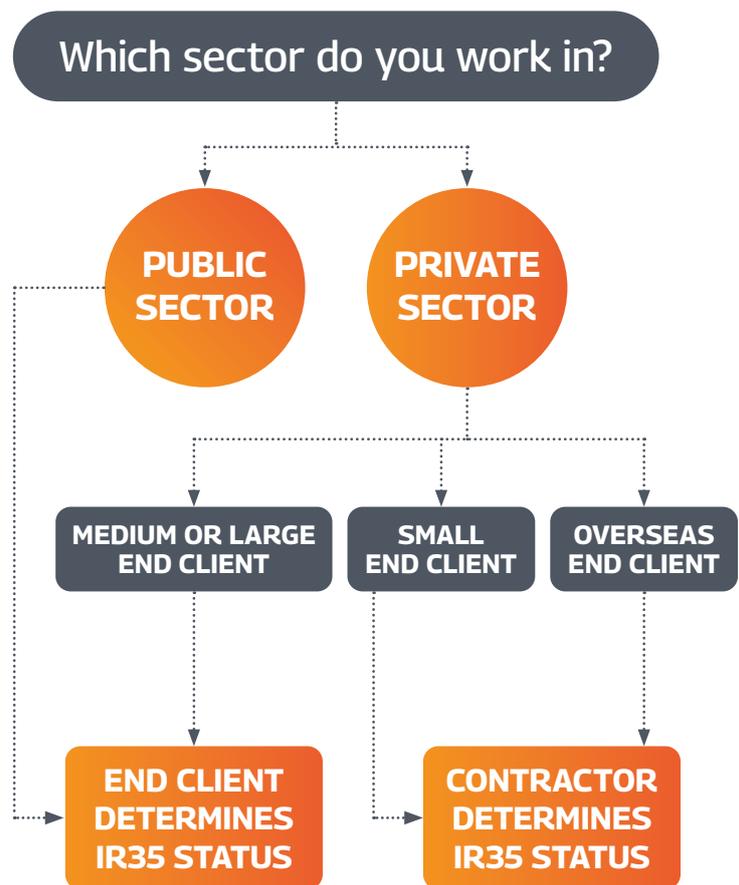
IR35 applies to a UK tax payer providing their services through a UK company, to an end client. Where you provide your services through an Umbrella company or Agency, an

intermediary exists but PAYE and NI are deducted at source so in effect you fall Outside of the Scope of IR35.

A self-employed contractor offering his services directly to an end client and not through a Limited company falls outside of the scope of IR35, but the end client will still need to be satisfied that you are genuinely self-employed or they face the risk of being seen to be the deemed employer.

Who Determines IR35 Status?

From April 2021, who determines your IR35 status will depend on who your end client is.



What Factors Determine Your IR35 Status?

There is no statutory definition of employment or self-employment for tax purposes, which means assessing IR35 status can be a complicated business. Case law is grey and confusing, so we strongly recommend getting a professional IR35 assessment from an independent expert.

Courts have established three key employment status indicator tests to consider when assessing IR35 status along with requiring us to consider the overall picture and nature of the relationship between contractor and end client.

IR35 has to be assessed for each new assignment, contract change and extension.

We have outlined the main tests, overleaf.



Key Status Indicators

Personal Service or Substitution

Where a contractor is required to perform work themselves, this is called personal service. Personal service is an essential feature of an employment relationship. If you can send someone else in to do your work, this is called substitution and suggests that you may not be an employee.

Too many restrictions on your right to send in a Substitute may mean HMRC seek to establish that you have no real right to send someone else in your place. In order for a genuine right of substitution to exist it should contain the following elements:

- It should not be a sham – a contractual right should be reflected in your end client’s practical approach to accepting a substitute
- Your end client should not have any right of veto or ability to refuse the substitute other than on the basis of them not being equally skilled or able to undertake the work. Security clearance may also be an allowable reason to refuse.
- You should be able to send in a substitute when you are unwilling and or unable to work
- You should retain responsibility for the substitute and pay them directly

HMRC have said that substitution must be ‘practical and plausible’. They have also suggested that sending in a substitute from a pre-approved list of contractors would not be seen as a genuine right to substitution, since your end client would have had discretion over who was placed on the list.

Control

As an employee you are likely to be under the direction, supervision and control of your employer but as a contractor, the level of control exerted by your end client should fall short of an employment relationship.

The control test has four elements:

What work the Contractor does, **How** the contractor carries out his work and **Where, When** the work is undertaken.

What – the end client should not control what you work on. Your contract should contain deliverables and milestones, rather than be for a “bucket of time”. Your end client should not be able to dictate that your unable to work for others whilst engaged by them.

How – As a contractor you should not be given detailed instructions on how to deliver the work for which you have been engaged. If your end client can dictate how the work is completed and has the right to direct you, this is an indicator that the assignment will fall inside IR35.

Where – Your end client should not dictate where the work is carried out, you should be able to work from a location that you choose. It is accepted that sometimes the task may dictate the location, for instance working on a particular high value system in situ at a client site. In this case “where” you carry out the task may be neutral for IR35 purposes.

When – Similar to above, this can be a neutral factor if the end clients opening hours and the work dictates the time. You should however be able to choose your own hours in order to complete the work and there should be no requirement for a minimum number of hours to be completed each week.

Mutuality of Obligation

In every contract there is a certain level of mutuality. Where one party promises to deliver a service to another for a fee, mutuality exists. The question is, does that mutuality amount to a master servant relationship demonstrating employment?

The following table explains what behaviours may indicate Mutuality of Obligation.

MoO EXISTS IF:	MoO DOES NOT EXIST IF:
<ul style="list-style-type: none"> • There is an obligation and expectation for further work to be offered and accepted • You agree to work exclusively for this Client • You are paid when not working • You are moved from project to project as the end client requires • You are required to work a notice period 	<ul style="list-style-type: none"> • You are free to choose the jobs you work on • You are not obliged to provide your services exclusively to your end client • Your end Client is not obliged to guarantee further work • Your end Client is not obliged to find you work when there is downtime on a project

In addition to the key employment tests there are a number of other factors that must be considered when looking at the IR35 status of a contract:

Intention of Parties

What type of relationship did you and your end client set out to establish? It should be clear from contract terms and your ongoing relationship that it is a business to business relationship and not one of employment.

Contracts will often state it is the intention of the parties not to create an employment relationship. This will be ignored if the reality is very different.

Business on Your Own Account

Do you look like you are operating as a business? Do you have a website, business stationary, an office? Do you provide your own equipment? Courts now look to establish that contractors are genuinely trading.

Financial Risk

Financial risk can be a key indicator of self-employment. Have you ever had an invoice remain unpaid? Do you have to correct errors and omissions at your own expense? Do you have to provide your own Professional Indemnity insurance? These factors can all indicate an "Outside" IR35 position.

Part and Parcel

It is important that you do not slip into becoming part and parcel of your end client's organisation. You should not feature on organisation charts, unless you are clearly shown as a contractor. You should not form any part of a formal HR process whereby you manage end client staff, take part in appraisals schemes or 1-2-1 meetings. Care should be given when you think about attending an end client meeting, project update meetings are fine but team meetings that focus on staff performance may not be.

You should not have access to the same perks and benefits as employed staff, for instance free car parking, gym membership or canteens.

Best advice is for you to ensure your contract and working practices align. You should gather data to demonstrate your IR35 position. Our guide to demonstrating you are outside IR35 provides more detail on what this evidence might be.

Weighting

When assessing IR35, it's important to understand that not all factors carry the same weight when balancing the evidence. The three key status indicator tests carry far more weight in case law than say for instance the fact that you may have more than one client or you don't have an end client email address.



How is IR35 Assessed?

Your end client has to apply "reasonable care" when assessing your IR35 status. IR35 assessments must consider contractual terms and working practices. There are three recognised methods of assessment that can be used individually or in conjunction with each other.

Contract Review

Your end clients can appoint IR35 experts to undertake a review of contractual terms and working practices. This process is likely to be very manual and involve face to face interviews with relevant parties. The results of the review will need to be written up into a formal Status Determination Statement (SDS).

Even if the IR35 assessment sits with your end client we strongly recommend you use an independent party to assess your situation. This can prove useful evidence if you choose to appeal your end client's decision and could also be beneficial if HMRC investigate your earlier tax years.

Commercial Tools

Commercial Assessment tools are available for IR35 determinations.

At Orange Genie, we use IR35 Shield. This is a cloud-driven IR35 Assessment software platform that uses existing case law and judges' rulings to accurately and compliantly determine a contractor's IR35 status. The tool takes a collaborative approach combining evidence from the contracts, the end clients view of working practices and your comments on how you operate your business.



CEST

HMRC launched their Check Employment Status for Tax tool in 2017 and subsequently improved this in 2019. The tool does not take a collaborative approach but asks the user to confirm which party they are in the supply chain.

CEST has been criticised for being too narrow in its application of the law. Mutuality of Obligation is omitted from CEST and results are based on singular status indicator tests rather than the whole picture.

HMRC issued guidance on how to use CEST and this gives end clients an insight in HMRC's take on IR35. We have written a guide on how best to approach the use of CEST.

HMRC have confirmed that they will stand by the results of CEST, assuming that the questions have been answered correctly and accurately, and in accordance with their guidelines.

What does Your End Client Need to Do?

Your end client has to determine your IR35 status, using "reasonable care". They must share their Status Determination Statement with you.

What is a Status Determination Statement?

Your end client will need to share with you their reasons for their determination of your IR35 status. This must then be passed down the chain to the agency through which you are supplied until it reaches the 'fee-payer'.

HMRC calls this a 'Status Determination Statement' (SDS) and has introduced it with the aim of increasing transparency with regards to assessments. Until your end client shares this with you and the fee-payer, they will carry the liability and therefore the risk.

A valid status determination must:

- Conclude whether or not you would be an employee or office holder, if you were directly engaged by the Client
- Provide their reasons for how they came to this conclusion
- Have taken 'reasonable care' in determining your IR35 status

What is Reasonable Care?

Failure to take reasonable care will invalidate the status determination statement.

HMRC have not defined 'reasonable care' but they have provided guidance. Your End Client must "act prudently" and assess all factors in as much depth as a "reasonable person in the client's position" would. Whether or not an end client has demonstrated reasonable care will depend on their "abilities and experiences".

What is accepted is that the blanket determinations that we saw in the public sector will not demonstrate "reasonable care."

An Appeals Process

Your end client must introduce a 'Client-led Disagreement Process', to provide you with the opportunity to challenge what you believe to be inaccurate status decisions. Your agency also has the right to challenge the determination.

End clients can determine their own processed but they are required to respond to an appeal within 45 days. Should they fail to do this and explain why they have made a particular IR35 decision, they will take on the feepayer responsibilities and therefore be liable for any unpaid tax and NICs.



What Does Your Recruitment Agency Need to Do?

If you contract with your end client through an agency, the agency is likely to be the party paying your Limited company. In this case the agency become the feepayer under the new legislation.

If you contract directly with your end client and they pay your Limited company they are the feepayer.

Fee-Payer Responsibilities

Where an assignment is deemed to be inside IR35, as per the SDS provided by your end client, the fee-payer becomes the employer for tax purposes. The feepayer is responsible for deducting the relevant tax and NICs from your invoice before paying the net pay plus any VAT to you.

While fee-payers become the employer for tax, they will not become the employer in law and you will not gain any employment rights.

The fee payer also becomes responsible for other costs of employment such as employers NIC and the apprenticeship levy.

Debt Transfer Provisions

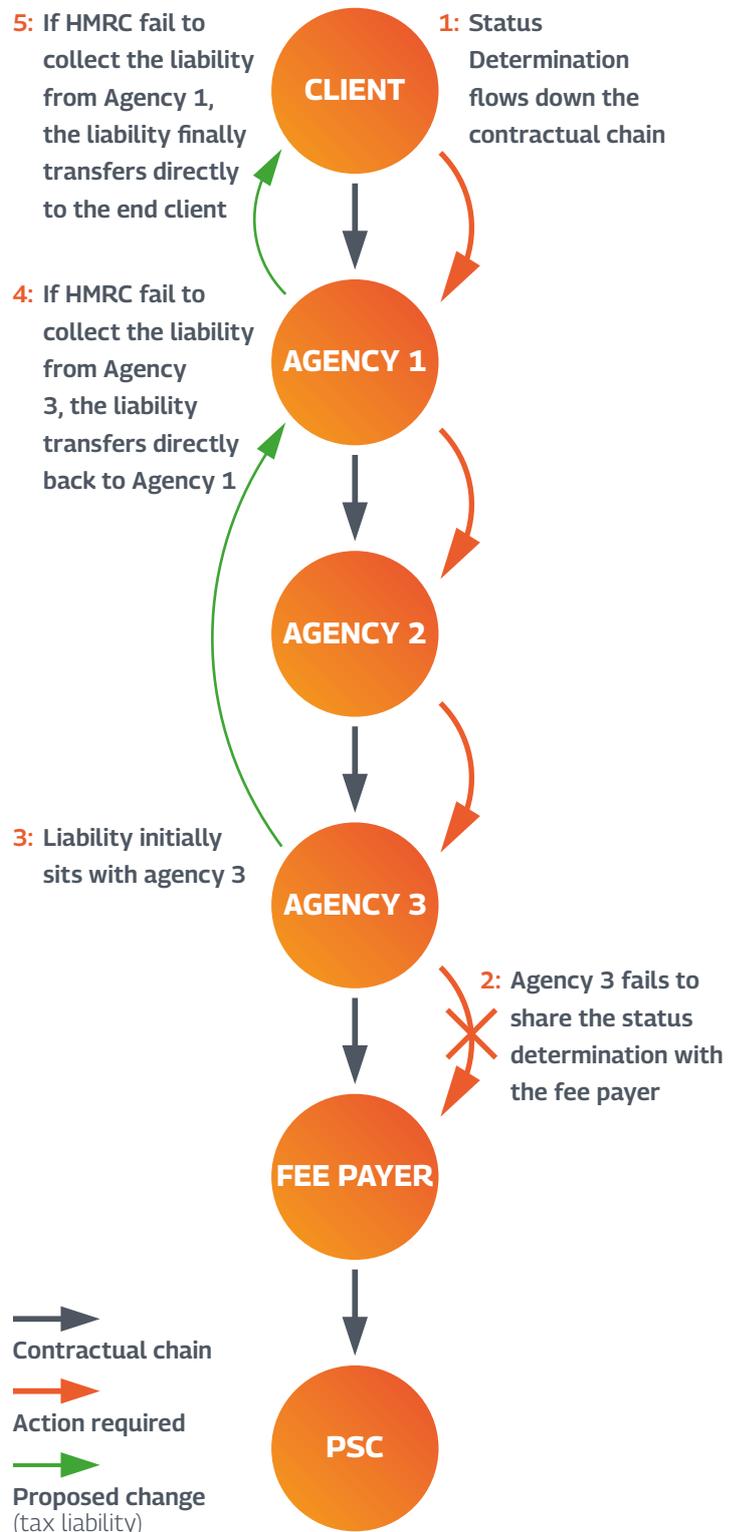
IR35 reform introduces wide reaching powers for HMRC to collect PAYE that goes unpaid from other parties in the supply chain.

Where your end client has complied with the legislation and passed the SDS to your agency and yourself, the agency as fee payer is responsible for deducting PAYE and NIC. If HMRC cannot recover the liability from your agency, they will move along the supply chain in order to recover the unpaid tax.

Ultimately if they are unable to recover the unpaid tax from your agency, they will move to the end-client.

HMRC's view is that your agency or end client for a direct hire has the best visibility of the supply chain and so are in the best position to drive compliance.

Where a party in the supply chain fails to meet their obligations, they will become liable for the tax and NIC. HMRC have stated that they will not enforce this unless a tax avoidance scheme has entered the supply chain. This means they will not invoke these powers in the event of genuine business failure.



NOTE: The tax liability can only be transferred if the reason for non-compliance is a tax avoidance scheme. In the event of a genuine business failure, HMRC will not be able to chase the other parties in the chain.

What Can You Do if You're Found Inside IR35?

If you have appealed your situation and lost, then you need to decide if you will accept your end client's assessment or seek an alternative contract. It may be that there are other end clients in your sector who are looking to work with Contractors on an Outside IR35 basis and you may find them a more attractive option.

Remember, if you can find a contract with a "small" end client you will remain responsible for your own IR35 status. Whilst it is important that you assess yourself correctly, smaller and start up end clients may offer more Outside IR35 opportunities.

It may seem like a drastic option but it maybe that seeking a contract outside of the UK will suit you. HMRC guidance has confirmed that where your end client is wholly based outside of the UK and has not significant presence here, you will remain responsible for your IR35 status.

Accept the Inside IR35 Decision

If you do accept the Inside IR35 decision you and your end client will need to determine how you engage in the future.

Whatever the method of engagement tax and NIC will need to be deducted from your payment at source. Many contractors report that their take home pay "Inside" IR35 is reduced by at least 25% and yet they have not benefitted from any employment rights or statutory payments such as sick pay or holiday pay.

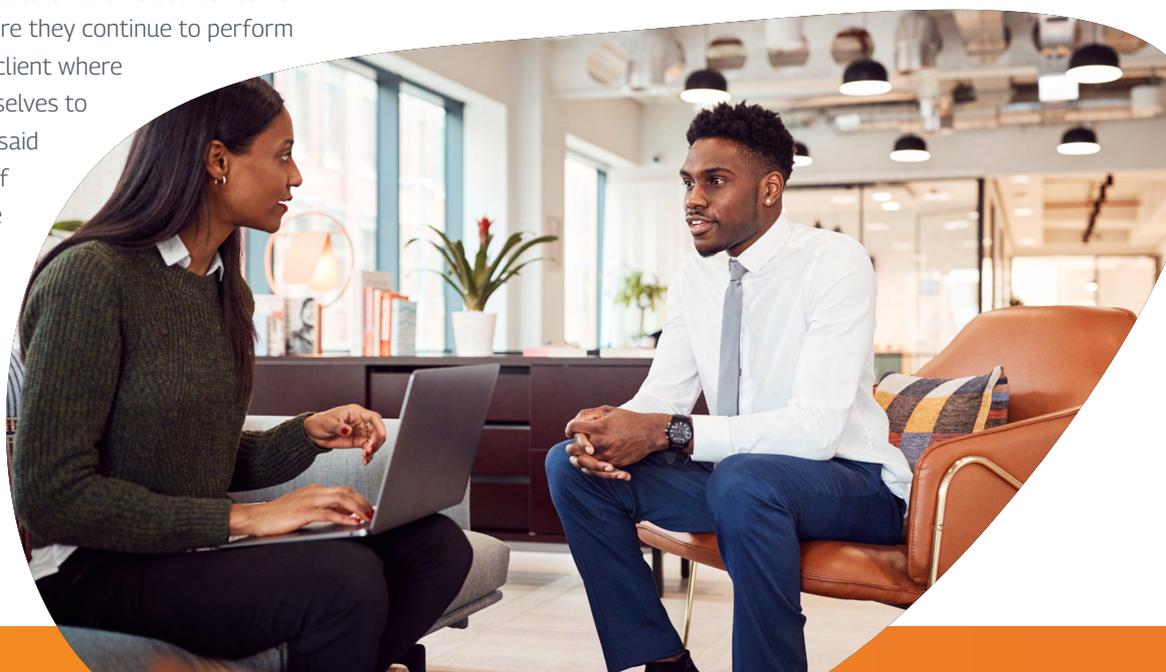
A note of caution, many contractors have voiced concerns over HMRC investigations where they continue to perform duties Inside IR35, for an end client where they previously deemed themselves to be Outside. Whilst HMRC have said they will not use the change of rules to open up retrospective investigations it is a risk you should be aware of.

Working Inside IR35

Your end client, in conjunction with your agency, will have decided which models they wish to use when engaging with "Inside" IR35 contractors.

There are four main options, the first three of which are employment models whereas the fourth would still utilise your Limited company:

- **Direct employment** - your end client may consider making you part of their permanent head count. You will need to decide if the package on offer is acceptable to you. Remember that as well as the financial rewards, this route will offer full employment rights and some level of security.
- **Agency PAYE** - your end client may wish to engage you as a temporary worker through the agency's payroll. This route offers some employment rights whilst on assignment but you do not benefit from continuous employment.
- **Umbrella Employment** - this route offers you continuous employment under an overarching contract. You can work at multiple end clients all under one "umbrella". You will receive one payment with the correct taxes deducted and you will receive all the benefits and perks of a direct employee.
- **Fee - payer model** - your end client and agency may still engage with your Limited company. In this model the fee-payer would have to deduct PAYE and employees NIC from your net invoice value before sending you the payment. You would then need to account for this in the books and records of your business. Provisions are in place to avoid double taxation. Your accountant should be able to explain further.



Jargon Buster

Assignment	A specific piece of work or project for a particular end client	IR35	The common name for the Intermediaries Legislation, taken from the reference number of the HMRC press release in which it was announced
Blanket Determination	Where all contractors are deemed "Inside" of "Outside" IR35 without considering individual	IR35 Status Review	Professional examination of a contractor's IR35 status carried out by a specialist expert
Blanket Policy Decision	An end client has decided to no longer engage with Limited company contractors going forward. They are therefore not obliged to consider IR35	Limited company	A private business where the owner's debt responsibility is restricted to the amount invested. A common way for contractors to conduct their business
Case law	"Rules and guidance derived from decisions made in previous cases. A collection of past decisions made by Courts where the law was applied"	Mutuality of obligation (MOO)	The extent to which an end client is obligated to offer additional work and/or the contractor is obligated to accept. Important for determining IR35 status
Check Employment Status for Tax (CEST)	HMRC's online tool, intended to be used by contractors and clients to determine IR35 status	Off payroll working	"When a organisation engages workers and does not pay them through their payroll. This includes paying an intermediary for work completed by a contractor"
Arrangements	A document confirming how a contractor operates on a day to day basis, particularly as this affects their relationship with an end client	Office Holder	Rules and guidance derived from decisions made in previous cases. A collection of past decisions made by Courts where the law was applied
Contract for services/ contract of service	The worker's contract with the end client. If outside IR35 this will be a "contractor for services". Employees have a "contract of service"	Outside IR35	In business on their own account
Control	The extent to which an end client controls when, where and how a contractor completes the work. Important for determining IR35 status	Personal Service Company (PSC)	A small limited company used by a contractor to supply their services
Deemed employment payment	Payment made to a contractor who is inside IR35, after deductions for PAYE tax and NICs	Private Sector	Privately owned businesses and commercial firms
Disguised employee	A contractor who is inside IR35, or employed for tax purposes	Public Sector	Public services and government organisations
End client	The company/organisation the contractor provides services to	Recruitment agency	A business who source work for contractors, and contractors for end clients
Fee payer	The company/organisation who pays the intermediary (eg. a PSC) for work completed by the contractor. Usually an end client or recruitment agency	Small private-sector business	"Exempt from the April 2021 reform. A privately owned business that satisfies two of: turnover £10.2 million or less, Balance sheet total of £5.1 million or less, 50 or fewer employees"
HMRC	Her Majesty's Revenue and Customs, the UK tax service, formally known as the Inland Revenue	Substitution clause	Provision in a contract to allow a contractor to send a suitable alternative rather than completing the work themselves. Important for determining IR35 status
Inside IR35	Deemed to be employed for tax purposes	Supply chain	A succession of organisations involved in the supply of services from the contractor to the end client
Intermediaries legislation	Legislation designed to tackle perceived tax avoidance by contractors working through intermediaries when they would otherwise be employees	Working Practices	The day to day reality of the contractor's relationship with the end client. Important for determining IR35 status
Intermediary	The entity through which a contractor provides their services, eg a Limited company		

What is IR35?

IR35 is the common name for the HMRC rules that govern the tax status of off-payroll workers. The legislation is designed to stop “disguised employment.”

What is changing in April 2021?

The responsibility for assessing employment status is changing. Contractors have been responsible for assessing their own status. From 6 April 2021 the “hirer” or end client will be responsible for ensuring all individuals have been assessed and all relevant taxes deducted.

What are the critical factors that determine if a contractor is “Inside” OR “Out- side” of Umbrella Company?

The changes have no effect on contractors engaged through PAYE or those providing services through an Umbrella company – it only affects workers using Personal Service Companies (PSC’s) who are deemed to be in scope.

What are the critical factors that determine if a contractor is “Inside” OR “Out- side” of IR35?

There is no statutory test. Employment status is assessed using case law precedent and there are three key employment status indicators. These, when taken on balance, determine whether a role is inside or outside of IR35. These indicators are:

- **Substitution** – can the contractor substitute another person for themselves?
- **Control** – how much control does your end client have over “what”, “where”, “when” and “how” the contractor works?
- **Mutuality of Obligation** – does a relationship exist that suggests the employer and employee are bound to each other as they would be in an employment relationship?

What does “Inside” IR35 mean?

If a role is “inside” it means the contractor is deemed as an employee (for tax purposes only) and relevant tax and national insurance need to be deducted.

What does “Outside” IR35 mean?

If a role is outside it means the contractor is not deemed as an employee (for tax purposes), can pay corporation tax, and can draw income as dividends from their Personal Service Company.

The changes to IR35 means that we are responsible, as the “hirer”, for taking reasonable care that employment determinations are correct. If the hirer does not do this, we will become liable for any unpaid tax and national insurance.

Does this mean that all contingent workers will become PAYE?

Individual assessments need to be undertaken to accurately assess each individual and provide an independent ruling for each contractor. Individuals who are “outside” IR35 can continue with their current operating through their PSC.

Individuals who are deemed to be “inside” of IR35, are likely to have the following options:

- Transfer to a PAYE model
- Remain operating as a PSC but “Inside” IR35 (and be taxed at source accordingly)
- Appeal the result
- Give notice they wish to leave

Will my end client uplift pay rates to cover the increase in tax obligations if I am deemed “Inside” IR35?

If you are deemed “inside” you are deemed an employee for tax purposes. End clients are not obliged to increase rates, this something you will need to negotiate.

IR35 FAQs

Will my end client accept an IR35 assessment from my accountant or via CEST?

Each end client is free to determine their own process for determining IR35 status. You will need to refer to their policy to determine what they will accept as part of the initial determination and/or appeals process.

Will my end client report contingent workers who were previously out-of-scope to HMRC?

The law changes on 6 April 2021. End clients will apply the results of the SDS for the tax year 2021-2022. Your tax affairs for the financial years 2019-2020 and 2020-2021 are your own.

Will HMRC investigate my tax affairs for previous years if I am deemed to be “inside” IR35?

HMRC have stated that: “it is ... possible that you will pay additional income tax and NICs if you had not previously been applying the off-payroll rules (IR35) correctly. However, HMRC will not use information resulting from these changes to open a new enquiry into earlier years unless there is reason to suspect fraud or criminal behaviour.”

It may be useful to refer to the following guidance document from HMRC: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/857148/Contractor_factsheet.pdf

If a contractor is assessed as “inside” IR35, does this mean they have the same employment rights as a full-time employee?

There is a difference between employment law and tax law. Being “inside” IR35 does not mean that the contractor has the same employment rights as a permanent employee.

Can my end client change working practices so that I remain out of scope?

It may be an option in some cases. You will need to talk to your end client and see if they are prepared to work with you to achieve this.

Can I get a Statement of Work?

It may be an option in some cases. “Statement of Work” refers to specific contracts based on milestones and deliverables rather than time and materials. A Statement of Work, in itself, is not a “magic bullet” for IR35.

Current roles would need to be carefully and legally re-defined so that the contractual relationship is based on:

- Clear milestones and deliverables
- Payment by results rather than hours worked
- Tasks undertaken at a time and place of the contractors choosing
- Clear evidence that the role is not under day-to-day control / supervision / method
- The ability to use Substitutes

A change to Statement of Works is likely to require a real change in working practices and relationships. Any proposed changes would have to be realistic and operationally feasible. The engagement would be subject to both initial, and ongoing, assessment to ensure you remain compliant with IR35.

Will joining an Umbrella Company get around IR35?

Where a role is “inside” IR35 the umbrella company would treat the contractor as an employee. Appropriate PAYE and NIC would be deducted. In effect the contractor will fall outside the scope of IR35.

My appeal was unsuccessful. What if I still disagree with the SDS after the appeals process?

There is no statutory right of appeal to an adjudicator or third party. Contractors can reclaim what they perceive to be overpaid tax via their self-assessment although this is likely to lead to an enquiry.

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