

A man and a woman in business attire are standing in an office, looking at a document together. The man is on the left, wearing a light-colored shirt and trousers, holding a coffee cup. The woman is on the right, wearing a light-colored blouse and jeans, holding a document. They are both looking down at the document. A horizontal bar with a gradient from purple to pink is positioned above the title. The background is a blurred office environment with a desk and a laptop visible in the foreground.

# IR35 preparation playbook



# What is IR35?

IR35 is the commonly used term for the legislation introduced nearly 20 years ago to prevent “disguised employment” tax avoidance.


In simple terms, this occurs where an individual, who for all intents and purposes would be an employee of an end user “client”, operates through an intermediary vehicle such as a personal services company (PSC) to avoid income taxes and to manipulate national insurance contributions. Avoidance comes when the disguised employee takes advantage of the lower taxation treatment of corporates compared with the higher rate for individuals.



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# Who is outside IR35?

Someone who is placed “outside IR35” must be a genuine independent contractor. If this is the case, their PSC can be paid gross, without deduction for tax or National Insurance Contributions (NICs) by the client or staffing agency, as the case may be. Accordingly, the relationship between the client, the PSC and its employee who is actually performing the work can be treated as a service supply relationship.

Employment status is not an easy question to answer. A whole industry has grown up around trying to solve it for would-be independent contractors. HMRC has struggled to create a test which simply resolves the question. HMRC’s “CEST” (Check Employment Status for Tax) is widely regarded as inadequate even by its creators – not because it’s inconsistent, but because it is often inconclusive.



# Four key tests

## Mutuality of obligation

Does the contractor have to accept work? Is the client obliged to provide it? If the answer is yes, then there is likely to be a mutuality of obligation. If no mutuality of obligation exists, they could fall outside of IR35.

## Substitution

Does the role allow for the contractor to send a substitute in their place, at their own cost? For example, if the contractor is taking time off for medical reasons, can they send someone in their place? If they can't send someone else, they could be within IR35. The test is not whether a client can use someone else or whether an agency can provide an alternative.

## Supervision and control

This is often tricky to overcome in professional settings. A contractor agreement that specifies terms such as mandated working hours points towards employment (inside IR35) rather than self-employment. However, "Supervision and Control" also does not mean that a contractor cannot be managed at all or a client cannot provide any instruction. The key point is that the contractor should not be dictated as to how they perform their work on a day-to-day basis.

## Part and parcel

If contractors are embedded in the company structure, this is more likely to be employment rather than self-employment, and therefore likely inside IR35. For example, does the contractor have line management responsibility for the client's employees?





# What is changing?

There is a tremendous amount of press around changes to IR35. The reality is that the underlying law will stay the same. If a contractor were genuinely outside of IR35 on 5th April 2020, they would continue to be outside of IR35 on the 6th April 2020 when the law changes.

Similar rules were introduced into the public sector in 2017. At the time there was considerable criticism that those changes had not been thoroughly thought through, not fully consulted on and generally rushed. Despite this criticism, HMRC hailed those changes as a success. The draft legislation was published on 11th of July, and as expected hasn't changed from the consultation. It reflects the public sector changes very closely. There is a limited exclusion for small companies.

Currently, in the private sector, contractors are responsible for making their assessment as to whether they fall inside or outside of IR35. If they make the assessment incorrectly, it is the contractor, not the client or agency who is liable for unpaid tax and NICs (including employer NICs). HMRC believe that abuse of the system is widespread, but enforcement against numerous individuals is difficult and resource intensive. The answer? Move the assessment and the liability up the supply chain to those who are much more likely to be compliant and have assets.

## Changes from 6th April 2020 to prepare for

- The client will be responsible for determining whether a role is inside or outside of IR35, i.e., if contractor's fees must be taxed as though the contractor were an employee.
- Responsibility for accounting for tax and NICs will rest with the fee payer (i.e., the body responsible for paying the PSC – this may be the client where there is a direct relationship with the PSC, or the agency where there is an agency in the supply chain). The fee payer will also be responsible for accounting for employer's NICs and the apprenticeship levy.
- Liability for tax and NICs could pass to the client if it has failed to take "reasonable care" in making the decision. It is not clear as to what constitutes reasonable care. Liability could also pass up the chain if the fee payer cannot pay (e.g., it has become insolvent).
- The contractor will be entitled to know how the decision is reached. Consultation around the timing of the decision and how it is communicated is one of the ongoing debates.
- An appeal process to the client by the contractor must be available if they do not agree. HMRC will not have any specific appeals process, and the contractor can only raise disputes through the income self-assessment process.
- HMRC have stated the tool will be updated but have not given a timeline.

A background image showing two men in a professional setting. On the left, a Black man in a light blue button-down shirt is looking towards the right. On the right, a white man with a beard in a blue button-down shirt is looking towards the left. They appear to be in a meeting, with papers and a laptop visible on a table in the foreground.

# Auditing your contractor population

One of the learnings from the public sector is that many organisations took a very simplistic approach to assessment and in some cases simply blanket categorised genuine independent contractors as inside IR35 and placed these contractors on PAYE contracts. This led to increased costs for those organisations but also highly skilled contractors moving to the private sector.

Anecdotally, many public sector organisations are now reengaging with contractors, who qualify, outside IR35. Obviously, with the latest changes, contractors will not be able to switch sector to avoid what they may see as a prejudicial determination. However, over-compliance may well take place. Given that the changes will impose an appeal process on clients, a blanket approach in the private sector could create a significant administrative burden for clients.

“There will likely be a period of disruption as the market adjusts to the new state of play (per public sector experience). However, the contracting industry has survived an onslaught of legislation over the past two decades – there are steps that can be taken to mitigate the risk of contractors being unnecessarily caught by IR35.”

Nicola Hayman, Legal Manager at Kingsbridge





# What are your options?

Once you have completed the audit of your contractor population, you can determine what options are available to you:

## Remain outside of IR35

There will be a portion of the contractor population that will be outside of IR35. This option retains the status quo, and insurance products are likely to be able to mitigate the risk of an incorrect determination.

## Pay as you earn (PAYE)

Contractors can convert to become PAYE engaged individuals.

There is a significant risk that a contractor will terminate their assignment if this happens. Suppose a contractor is performing a role on 5th April through a PSC and has been doing so for several months. On 6th April, the client reclassifies them as a PAYE worker inside of IR35. The role is the same, but the result of the determination is different. This is a potential red flag to HMRC that the contractor's "self-assessment" was wrong.

Another consideration when converting a PSC to a PAYE is that they could claim security of employment tenure if they then have or later acquire two years of continuous service. For example, a long-term contractor who had converted over could claim for unfair dismissal or expect to be included within redundancy consultations.

Converting PSCs could also, in some cases, attempt to claim under the Agency Worker regulations. This is not the intention of the legislation but could be an unintended consequence.





## Deemed model

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The contractor can remain a contractor and can remain as the director of their PSC, but, for this particular assignment, is “deemed” inside of IR35, and the agency then has to withhold the appropriate taxes. This is helpful where a contractor flips between assignments to which a different status will attach.

## Umbrella

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If determining that a lot of roles will be inside of IR35, it may be an option to offer the services of an umbrella company to contractors, as the umbrella will withhold necessary taxes, but also offer PAYE benefits to the contractors (health, pension, loyalty schemes, etc). Using an umbrella contractor could also help mitigate IR35, as the contractor would be an employee of the umbrella company.

## Statement of Work (SOW) solution

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If a piece of work can genuinely be delivered through milestone and deliverable based outcomes, then SOW is a viable solution. With a SOW, the agency becomes the “end user” rather than the client. However, the agency will still face the same issues of IR35 determination if it uses contractors to fulfil its tasks.

Although on paper a SOW can appear to be a genuine service provision relationship, if the reality is that it is not genuine, and therefore the client is really the “end user” not the agency, liability for incorrect payment of tax and employers’ NICs could fall to the client. The client will not have made any assessment because, supposedly, it was not their responsibility and therefore they could not have taken reasonable care. This places the client in a worse position than if they had made the assessment with reasonable care, but simply got it wrong. It is our view that sham SOWs could be an early target for enforcement.

SOW requires more work and thought to put in place successfully – deliverables need to be properly managed, described and measured. This leads to additional cost to the client.





## Next steps

The changes to IR35 are very much about industry self-policing rather than enforcement. It is still the case that HMRC does not have significant resources to pursue large numbers of contractors they suspect of being incorrectly determined as outside IR35 even if through their clients. That is not to say that they will not pursue cases, and indeed may look to a high-profile scalp if they believe the measures are not creating the right compliance culture.

“There may be a temptation for over-compliance by clients, and this could be a problem for HMRC when contractors dispute the position through self assessment — clogging a system which had become efficient for the most part” says James Winter, Director of Internal Operations at Resource Solutions.

Another knock-on consideration is that some individuals' work permit status could be affected if they are to become PAYE temporary employees rather than self-employed PSCs – for example those working under Tier 1 Entrepreneurial Worker Permits. The status of PSC using these permits was always somewhat tenuous and it may well be the case that affected individuals will not be able to continue working unless sponsored as a fixed-term employee of the client or the agency. Both options are difficult to achieve and unattractive, especially for short-term assignments.

Finally, waiting in the wings are the outputs of the government's Taylor Review. One of the key points from the Taylor Review was to look at Tenure limits, with the Taylor reviewing suggesting that 12 months may be optimal. Whilst the government has indicated a desire to adopt all of the recommendations from the Taylor Review, at present only a small number are due to come into effect in April 2020, and Tenure limits is not one of them. However, if the government was to adopt 12 months as a limit, this could further impact the use of contractors for a sustained period of time, i.e. an on-going project.





# What should you do next?

It is critical to recognise that it is the assignment which requires assessment and not the contractor, who throughout their career may undertake some roles which will fall outside of IR35 and others not. There is a common misconception that simply using a PSC is enough.

The best starting point is gaining a detailed understanding of what each existing assignment entails, how the contractors perform their work, and the contractual basis on which it is done. Carrying out a thorough and methodical audit is the tool to gain this knowledge and insight. There also needs to be a process to capture the same information for new assignments.

Ashley Olliver, Business Development Director at PayStream comments, “educate yourselves on IR35 and try to determine sooner rather than later where your contractors are likely to land with regards to the legislation.”



Now that the legislation is published, it is imperative that you start your contractor audit and understand who is operating in your organisation and the cost impacts surrounding IR35 to you and your contractor base. Use this time wisely to understand your options and to start the communication process with your contractors; don't leave them in the dark.



James Winter, Director of Internal Operations  
at Resource Solutions

## Thinking ahead

Although the changes to IR35 are not retrospective, contractor assignments already in flight will be affected from 6th April 2020. Clients will need to have come to a position on the IR35 status of each assignment well ahead of the change, as they will be required to have made the assessment so that any appropriate tax and NICs can be accounted for from 6th April 2020. All contractors' assignments should be reassessed.

“From the audit, each role will need to be assessed and determined for IR35 purposes, although it may work to make some assumptions – for example, roles under a certain day rate are deemed to be inside IR35” says James Winter.

The CEST tool can be part of the determination; however, it can provide inconclusive results. Alternative tools and services will be available to supplement CEST. These are likely to be mandatory if clients and agencies wish to take advantage of some of the new insurance products that will be available to protect the supply chain against making incorrect assessments.

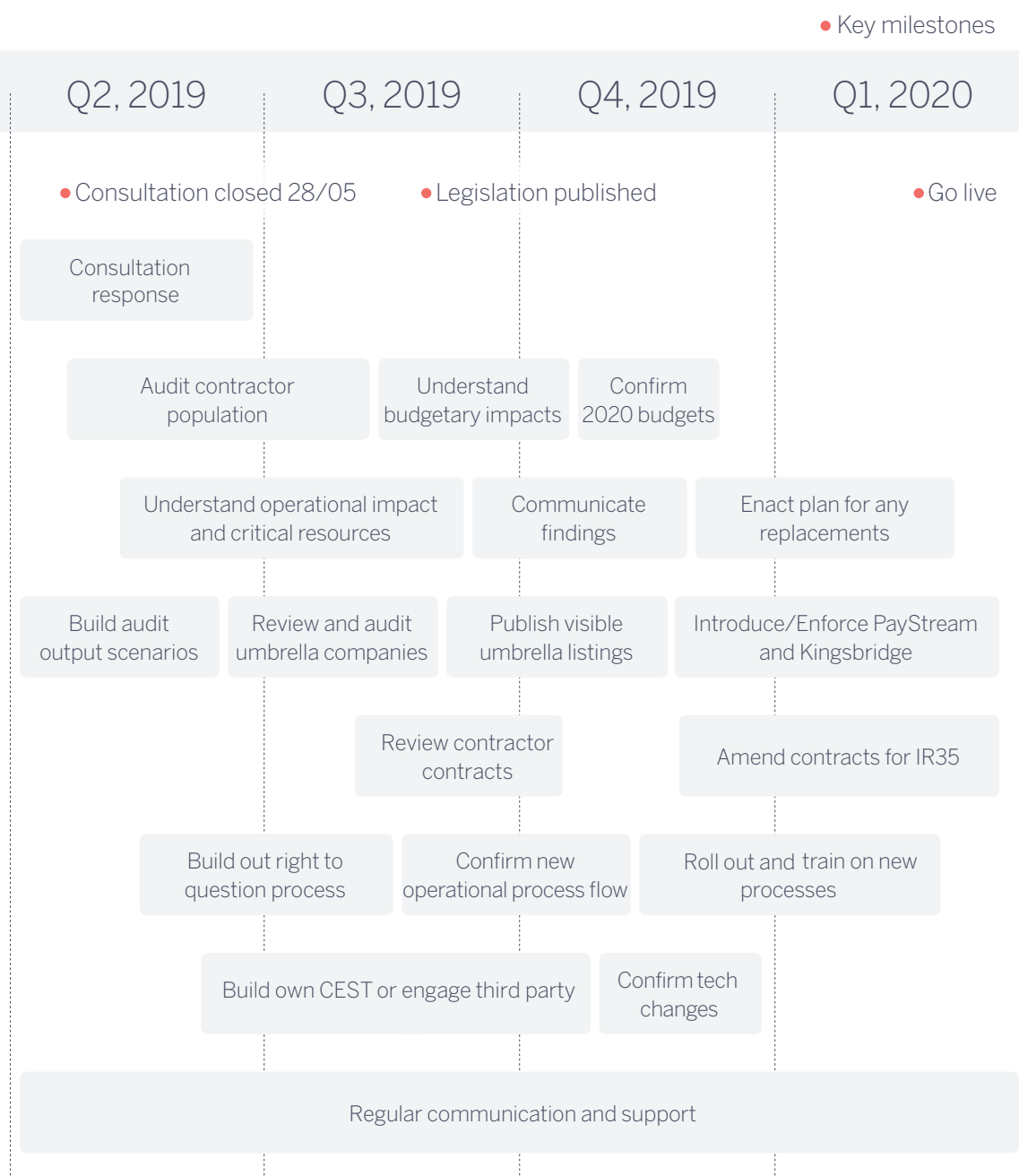


## 7 key learnings

- 1 Take time to understand the legislation now that it is published.
- 2 Liability is expected to pass up the chain so HMRC can ensure they get any tax owed.
- 3 Contractors will have a right to know how a decision has been reached.
- 4 HMRC intend to update their CEST tool before April 2020.
- 5 Analyse your contractor base, identify who is high-risk.
- 6 Carry out role assessments.
- 7 Implement an IR35 review process.



# Resource Solutions' IR35 action plan



Australia  
Belgium  
Brazil  
Canada  
China  
Chile  
Czech Republic  
France  
Germany  
Hong Kong  
Indonesia  
Ireland  
Japan  
Luxembourg  
Malaysia  
Mexico  
Netherlands  
New Zealand  
Philippines  
Portugal  
Singapore  
South Africa  
South Korea  
Spain  
Switzerland  
Taiwan  
Thailand  
UAE  
UK  
USA  
Vietnam

## Connect with us

Find out more about how you can prepare your business for the upcoming IR35 legislation:

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