

# IR35 Off-payroll working in the private sector: the issues



Please read in conjunction with [IR35 OPW in the private sector: solutions](#)

## the issues

Limited companies (often referred to as personal service companies) have been widely promoted and used by contractors to provide their services to hirers, typically via recruitment agencies. Since April 2000, IR35 legislation has tried to dictate whether the contractor is a disguised employee of the hirer (inside IR35) or, is in business on their own account (outside IR35). The answer has a material impact on the contractor's net pay. Under the former the contractors pay from their limited company is taxed as salary, and under the latter their pay is paid by way of expenses and dividends which saves the contractor £000's in tax and employers national insurance each year.

HMRC's issue is that in the private sector the contractor makes the decision on whether their assignment is inside or outside IR35 and they believe that 9 out of 10 of the outside IR35 decisions are incorrect, losing the government millions in tax revenue each year.

## public bodies

In April 2017 Off Payroll Working legislation was brought into the public sector making public body hirers responsible, and not the contractors, for making the IR35 decision. The logic being that the hirer should know whether the contractor is working independently and not under their control or conversely, whether the contractor was working in a similar way to an employee.

The overwhelming majority of decisions by hirers were that contractors were caught by IR35. As a result, HMRC deemed the new legislation a great success.



## private sector

From April 2021 the legislation will be rolled out to the private sector. Any amendments will also be effective for public bodies. The hirer's IR35 decision and reasoning (status determination statement) will be passed down to the party it contracts with and the contractor. There will be an appeals process (to be used where an inside IR35 decision is made), but in our opinion this will have a limited effect on a hirers decision and is 'window dressing'.

Each party must pass the status determination statement on to the next party in the contract chain. Failure to do so will make that party liable for any potential tax during the period they do not pass on the statement.

HMRC's CEST tool (check employment status for tax) allows hirers to check whether an assignment is outside IR35. If the tool says it is, and all answers were accurate and given in good faith at the time, then HMRC say they will standby the decision and not challenge it.

There are many critics of this tool saying it is not fully based on case law, however in our opinion hirers who make an outside IR35 decision should use the tool to reduce their tax risk. Why would you not use it? For long assignments the IR35 decision should periodically be re-reviewed.

There will be many companies offering independent reviews. It is wise to understand their motives with many wanting contractors outside IR35 to maintain their ongoing revenue streams. They will not be taking the financial risk.

IR35 assessments can be made by role. They do not have to be made individually where contractors are doing the same role.

Please note small and medium sized hirers meeting two of the following three criteria will be exempt from this legislation: turnover less than £10.2m; balance- sheet total less than £5.1 million; number of employees less than 50.

risk

We believe that to understand how the market reacts to new legislation you must understand where the risk lies. Risk always dictates behaviours.

Under this legislation the risk, whether directly or via debt transfer, ultimately lies with the hirer. Clearly the primary risk is where the hirer decides that an assignment is outside IR35.

HMRC can challenge the decision and demand repayment of lost PAYE tax and national insurance plus penalties and interest for each contractor.

A hirer's gross financial liability for lost tax, national insurance, apprenticeship levy, interest and moderate penalties over a 3-year period for an average contractor earning £100,000 pa is well over £100,000.

Therefore, most hirers will not be prepared to take the financial risk over a tax change brought in by the government.

The risk is not only financial but also reputational - there are plenty of companies and individuals currently making the national news for apparently not paying the correct amount of tax.

An additional risk for the hirer is when a fee payer (if the contractor keeps their limited company the party who pays the limited company is called the fee payer) pays a limited company where the assignment is inside IR35. The fee payer must deduct the appropriate amount of PAYE tax and account for it correctly to HMRC.

If they do not do this HMRC can transfer the debt to any party in the supply chain including the hirer. In addition to reviewing their supply chain, hirers will want to ensure that any fee payer is both compliant and financially secure.



## outcomes

After understanding where the risk lies it comes as no surprise that the expectation is that hirers will decide that the vast majority of assignments will be caught by IR35. This was the case when the legislation was brought into the public sector.

Whilst it would be hoped that truly independent contractors will be allowed to continue operating via their limited company outside IR35, the direction of travel from the government is clear - they want contractors being engaged to ensure PAYE taxes are collected at source. This means post April 2021 most contractors will be working through compliant PAYE umbrella companies, agency PAYE or professional employment solutions.



There may be a number of contractors who are deemed crucial to a hirer. If these are not truly independent contractors outside IR35 then hirers may decide to give them a rate increase to compensate for the additional tax they will have to pay.

Another option for hirers is to outsource some or all of their contingent work to a company under a service contract sometimes known as a statement of work contract. The legislation then becomes the problem of the service company who would be deemed to be the hirer. The working practises must be outside IR35 otherwise HMRC will argue the contracts are a sham and the supply is actually a supply of labour caught by IR35.

Under all eventualities the hirer will want to have control over its supply chain to ensure compliance and financial stability.

## actions

A good starting point is for hirers to list all contractors who are engaged via their own limited companies anywhere in their supply chain, categorise them amongst other factors by role, pay rates, length of contract and whether they are crucial to the organisation.

Understanding the risks is clearly key in assessing any roles that may be considered as outside IR35.

Independent specialist advice may be sought to help review possible solutions.

A project plan including early communication to reduce noise would be beneficial.

Hirers may want to consider not putting in place contracts that extend past 5th April 2021 until they are clear on what solutions they will be using.

## conclusion

Consultation on the draft legislation will end on the 5th of September 2019. When the dust settles, in our opinion, IR35 decisions will be made reflecting the risk appetite of each hirer. In the public sector this meant most assignments failed IR35 and already at the time of writing in the private sector companies such as HSBC, M & G and Morgan Stanley have reportedly stated that they will stop engaging contractors who use their own limited company.

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