

IR35 Off-payroll working legislation: how will you pay contractors after April 2021?

grant



the issues

Since April 2000 IR35 legislation has dictated whether a contractor, who is providing services through their own limited company, is a disguised employee of the hirer and therefore their remuneration is taxed via PAYE as salary or, if they are self-employed and in business on their own account, their remuneration can be paid as expenses and dividends saving the contractor £000's in tax and employers national insurance each year.

In the private sector the contractor decides whether they are inside or outside IR35 (and therefore how much tax liability they have). HMRC believe that 9 out of 10 of the outside IR35 decisions made by contractors are incorrect losing the government millions of pounds in tax revenue per year.

Therefore, Off-payroll working legislation was introduced into the public sector in April 2017 and is being introduced into the private sector in April 2021 (small private companies are exempt). This makes the hirer responsible for making the IR35 decision and, more importantly, taking the financial tax risk if HMRC argue that they were wrong to classify an assignment as outside IR35. Over a three year period the hirers gross tax risk for an average contractor earning £100,000 pa, including national insurance, apprenticeship levy, interest and moderate penalties, is well over £100,000.

In 2017 most public body hirers did not want to take any financial or reputational risk and therefore the vast majority of contractors were deemed by the hirers to be inside IR35. To minimise risk further hirers will want to ensure their supply chain is compliant. So what options are available to hirers and workers:

outside IR35

If a hirer deems that a worker is outside IR35, then given the financial risk they are taking, they will be very confident that the worker really is an independent contractor not under their direction and control. The hirer may have received an independent IR35 review but ideally they will have a confirmation from the HMRC CEST tool (check employment status for tax). CEST is an important tool because HMRC say they will stand behind the tool decision as long as the questions were answered accurately and in good faith.

Periodic re-reviews will be necessary for longer assignments.

It is worth noting that contracts for service, sometimes called statement of work contracts, will not on their own mean an assignment is outside IR35. It is always the working practises that are key, otherwise HMRC will argue the contracts are a sham and the supply is in fact a supply of labour caught by IR35.

inside IR35

For assignments that fail IR35 the options for contractor engagement all involve the deduction of PAYE taxes.

Clearly, where contractors are crucial to a project the hirer may consider giving a pay rate increase to offset the additional tax the contractor will pay.

umbrella

This will be the most used option as it was in the public sector.

Umbrella companies will employ the contractors and be liable for all employment risk. They will also manage the variable timesheets, variable pay, holiday, pension and statutory payments as well as all the contractor queries and grievances.

Hirers will need to ensure that only compliant umbrella companies are used.

The disadvantage of umbrella companies is that contractors often find their quoted and actual pay rates confusing. This is because they are quoted a limited company rate by the agency but upon speaking to the umbrella company realise that the umbrella company needs to deduct employer's national insurance, apprenticeship levy and their margin before you get to the contractor's real gross pay rate.

Payslips are therefore confusing because the contractor has to review an invoice reconciliation to understand the deductions which vary week on week depending on tax allowances and hours or days worked.

The government have realised this and as part of the Good Work Plan will bring in legislation in April 2021 which will force agencies to issue a Key Facts Document to contractors which will detail any deductions and provide a net pay illustration. Whilst this will make it clearer to contractors, it will also increase the number of queries to agencies and therefore hirers. Contractors may also ask for a higher pay rate to compensate for the deductions.

In our opinion, this opens the door for PEO or professional employment, which will see the fastest growth after April 2021.



PEO

Under PEO, or professional employment, contractors are employed by the PEO supplier. The contractor is quoted their actual gross pay rate and payslips are therefore easy to follow. Employer costs are agreed between the employer and the agency or hirer.

Like umbrella, the employer takes the employment risk and manages all aspects of time capture, invoicing, holiday and pensions management, statutory pay and grievances.

Contractors like this option because it is simple, easy to understand and leads to an enhanced experience with less queries which also benefits all other parties in the supply chain.

This option is already starting to gain momentum.

agency PAYE

Whilst the agency takes the employment risk and manages the payroll this option is limited by the fact that most agencies do not operate PAYE as an option for their contractors.

fee payer

A number of contractors will want to keep their limited company even though their assignment has been deemed to be caught by IR35.

The fee payer, the party paying the limited company, therefore has to deduct, account for and pay to HMRC employer's national insurance, apprenticeship levy and employee taxes and national insurance.

They also have to enter into a new contract with the limited company and manage and support the company and it's contractor.

If the fee payer does not pay the appropriate taxes then HMRC can transfer the debt to any party in the supply chain including the hirer. It is important that the hirer is confident that a fee payer acting in this capacity is both compliant and financially secure.



service contracts

Another option for a hirer is to subcontract some or all of their work under a service contract to another organisation who then becomes the hirer. This new organisation would therefore be subject to the off payroll working legislation. The terms of the service contract would need to be bona fide otherwise HMRC will attack it and argue that it is a supply of labour in which case the end user hirer would still be liable for the legislation and risk.

hirer PAYE

The hirer could employ the contractors directly. Although this gains control, it also puts all employment risk and payroll management with the hirer and does not align with hiring temporary resource over shorter periods.

For these reasons it is unlikely that this option will gain any momentum.

hirer permanent employee

There will be a minority of contractors who will become permanent employees of the hirer.

conclusion

All of the inside IR35 options involve the deduction of PAYE taxes. It is clear from the government over the last few years that this is the direction of travel for all workers irrespective of how they are defined. The government wants its fair share of tax revenue.

Some contractors may try to maintain their net income by using non-compliant intermediaries where there may be for example an offshore or loan scheme element. Hirers will want to review their supply chain to ensure compliance and avoid any potential liabilities under the criminal finances act, DOTAS, intermediaries legislation and so on.

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