

# Contractor Guide to the IR35 Off-Payroll Rules



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The extension of Off-Payroll rules to the private sector is set to come into force on 6th April 2020.

This guide is based on the draft IR35 legislation published July 2019. It may be subject to change when the final legislation is published and is for guidance purposes only. It should not be seen as a substitute for taking your own legal advice.

## Background

The IR35 legislation is intended to ensure that where individual contractors operate like employees their earnings are treated as employment income and taxed accordingly, regardless of the limited company or limited liability partnership structure the contractor works through.

IR35 applies where an individual (the contractor) provides their services through an intermediary (the agency) to another person or entity (the client).

## What is changing?

Under current private sector IR35 legislation, a limited company contractor ('PSC') is responsible for assessing the IR35 status of each of their assignments and is liable for any failure to apply IR35 correctly and for any errors in PAYE income tax and National Insurance contributions (NICs) made. To date, private clients and agencies have not had to involve themselves in the PSC's IR35 status. This is one of the key areas that will change when the new rules come into effect.

The April 2020 reform will extend the Off-Payroll working rules, which came into force in the public sector in 2017, to the private sector. This will mean that private sector clients will be required to determine a PSC's IR35 status and to communicate that determination to the party responsible for paying the PSC (the 'Fee Payer') – usually the agency paying the PSC (but if there is no agency then the client itself). If the assignment is determined as inside IR35, the Fee Payer will need to make deductions for employee PAYE income tax and National Insurance, as well as paying any employer National Insurance contributions.

This "deemed employment relationship" is for tax purposes only and does not grant any employment status rights to the PSC representative or impose any statutory payment obligations on the Fee Payer such as paid holiday, statutory sick pay, maternity pay, paternity pay etc.

### Assignments "Outside IR35"

If the client classifies the assignment as being "outside IR35" the contractor can continue to work through their PSC as normal.

### Assignments "Inside IR35"

If the client classifies the assignment as being "inside IR35" the contractor has three options available:

1. PAYE via Rullion – Rullion will contract with the contractor directly as a 'worker' and will make deductions from the worker's income for PAYE income tax and national insurance. The worker will also be entitled to worker rights such as holiday pay, statutory sick pay, maternity pay, paternity pay and will be auto-enrolled into a pension scheme etc.
2. PAYE via an Umbrella Company – the Umbrella Company will employ the contractor as an employee directly and make deductions for tax and national insurance. The contractor will

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also be entitled to worker rights such as holiday pay, statutory sick pay, maternity pay, paternity pay and will be auto-enrolled into a pension scheme etc.

3. Inside IR35 PSC – Rullion will engage with the contractor’s limited company and make deductions for both Employers and Employee National Insurance and income tax to calculate a “deemed employment payment”. The contractor will not be entitled to worker’s rights.

# Determining IR35 Status

For an accurate IR35 status determination the client must assess the actual day-to-day working practises that will apply to an assignment which both they and the contractor can expect to engage in. No single factor will be dominant. It is the overall picture that HMRC is interested in. The key factors considered in the determination are as follows:

## Control

*Who determines what, when, where and how the work is done, the client or the contractor?*

The contractor will need to be able to demonstrate a significant level of autonomy. The contractual documents and the working practices must show that the client has no influence over how/where/when the services are performed.

If the client has control, then this will tend towards an inside IR35 determination. If the contractor has control this will tend towards an outside IR35 determination.

## Mutuality of obligation

*Does the client have to offer work and does the contractor have to accept it?*

Mutuality of obligation is the obligation between master and servant to provide and accept work.

If mutuality of obligation exists between contractor and client the answer to the this will tend towards an inside IR35 and vice versa.

## Personal service

*Does the contractor have to provide their services personally or do they have a genuine right of substitution, and if so has it been exercised and how was the substitute paid?*

If the contractor does not have to provide services personally and does have a right to put in a substitute this will tend towards an outside IR35 determination and vice versa.

The right to substitution must be genuine and the client must accept a substitute if the initial contractor is not available to complete or provide the services. The right must be unfettered, which means the client can only reject the substitute based on the substitute not having the required expertise or security clearance. Any substitutes need to be paid by the contractor.

## Other potentially relevant factors

*Is the contractor taking a financial/ business risk such as having to make good any defects?*

*Is the contractor required to deliver a specific piece of work with defined outcomes and is payment based on those outcomes being delivered?*

If the answer to these questions is yes, then this will tend towards an outside IR35 determination and vice versa.

The contractor may have to take on financial risk in rectifying a poor-quality service at their own cost. Alternatively, he/she may have a contractual agreement in place that stipulates payment is conditional upon acceptance/satisfactory completion of services.

Other factors to be taken into account include: **the contractor providing their own equipment and the contractor being genuinely independent and not having become “part and parcel” of the client.**

If an assignment is determined “inside IR35” the PSC’s earnings will be treated as deemed employment income and paid by the Fee Payer (usually the agency) after deduction of PAYE income tax and NICs.

## Which private sector clients are within scope of the new rules?

The private sector legislation will apply to medium or large organisations only.

The statutory definition of what constitutes a small company in the Companies Act 2006 is used to determine whether a corporate client is identified as “small” and therefore outside the scope of the Off Payroll rules.

Section 382 of the Companies Act 2006 highlights the relevant provisions of qualifying as a small business:

If in a year a client company satisfies two or more of the following requirements:

1. Annual turnover not more than £10.2 million the required 45-day timescale;
2. Balance sheet total not more than £5.1 million;
3. Number of employees not more than 50;

it will be a small company and outside scope.

## Disputing an inside IR35 determination by a client

The legislation (as currently drafted) makes provision for the contractor to challenge the client’s status determination if they do not agree with it. This needs to be done in writing giving reasons why the contractor disagrees with the determination. The client must respond within 45 days and will either confirm the original determination or provide a new status determination. The initial client determination will stand during the dispute process. If the client confirms the original determination the PSC’s only further means of challenging it would be direct with HMRC through their tax return at the end of the relevant tax year.

# Frequently Asked Questions

## **Q: I am a limited company contractor and have always worked outside IR35. How will the proposed changes affect me?**

Under the current IR35 rules, you determine your own tax status. Neither Rullion nor the Client have any input. From April 2020, however, it will become the Client's responsibility to assess and determine your status for the purposes of each assignment.

The client's IR35 status determination will have one of two outcomes:

1. The assignment will be assessed as outside IR35 and you'll carry on as you are now;
2. The assignment will be assessed as inside IR35 and you'll need to change your payment method as the fee payer will become responsible for deducting income tax and NICs from your pay. This will either be:
  - through the Rullion payroll as a PAYE temporary worker;
  - via an umbrella company on a PAYE basis; or
  - by Rullion under the new Off Payroll rules as a net payment to your limited company after Rullion have deducted income tax and NICs at source from your invoice.

## **Q: If my assignment is determined inside IR35 what will the various payment options I could choose from look like in practice?**

1. PAYE via Rullion – Rullion will contract with you personally under a contract for services. You will be a worker and accordingly Rullion will make deductions for tax and national insurance from your gross pay. You will also be entitled to worker rights such as holiday pay, statutory sick pay, maternity pay, paternity pay and you will be auto enrolled into a pension scheme, etc.
2. PAYE via an Umbrella Company – the Umbrella Company will employ you directly and make deductions for tax and national insurance from your gross pay. You will be entitled to employee rights.
3. Inside IR35 PSC – Our 3<sup>rd</sup> party paying agent will engage with your limited company and make deductions for both Employer's and Employee's National Insurance and income tax from your invoiced amount to arrive at a "deemed employment payment". As Rullion will be contracting with your limited company, you will not be a worker and will not be entitled to worker's rights. However, as an inside IR35 contractor you will not be in business on your own account and will therefore be in scope of Agency Workers Regulations 2010 and entitled to the same pay and working conditions as if the client had employed you directly.

## **Q: If I work under a Statement of Work arrangement will I be outside IR35?**

That will depend on the circumstances. Your contract must reflect the actual day to day working practices. If you are simply converting a current time and materials contract to a Statement of Work ("SOW") contract there would be a concern that a SOW arrangement would not reflect your actual day to day working practices. However, SOWs are an option for new contracts especially for highly skilled, autonomous contractors who are often engaged to deliver a specific project within a specific

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timeframe and for a fixed price. If properly executed SOW contracts are more likely to be “outside of IR35” as there is less likelihood of client control and the contractor bears a genuine financial risk.

### **Q: How does the status determination process work and will I have any input into it?**

IR35 status determination is now the Client’s responsibility. There are third party IR35 determination specialists that can be used or the client might have their own internal legal assessment teams to undertake the task on a role by role basis. Alternatively they may rely on the updated HMRC assessment tool, CEST.

Rullion has the capacity to refer clients to third party IR35 determination assessors and as part of the assessment process you will be invited to answer a series of questions about how you see your status as a contractor and these will be taken into account alongside the Client’s evidence when reaching an ultimate determination. It is essential that the information you provide is accurate and a true reflection on your actual working practices.

### **Q: How will my take-home pay be affected by the new rules?**

If you have historically treated yourself as outside IR35 and your assignment[s] is/are now determined by the client as being inside IR35 then your income from such assignments will be deemed employment income and subject to income tax and NICs deductions. Employer’s NI will also be paid on your account to the statutory authorities by the Fee Payer (usually the agency).

Where assignments fall inside IR35 contractors who have previously treated their earnings as falling outside are likely to see a drop in net income.

### **Q: I work for multiple clients, does IR35 still apply?**

Yes, it does apply as your status is assessed on an assignment by assignment basis which means you could work on “inside IR35” and “outside IR35” assignments throughout the year.

### **Q: Do I get worker’s rights if I am inside IR35?**

Being inside IR35 is a tax determination and does not automatically give a contractor workers’ rights such as paid holiday, statutory sick pay, statutory maternity/paternity pay or pension etc. If you continue to work through your limited company, then you will not be a worker for the purposes of such rights. As an inside IR35 contractor you will, however, be within the scope of the Agency Worker Regulations 2010 (AWR) because you will, de facto, not be in business on your own account.

Alternatively, if you decide to work on a PAYE basis directly through Rullion or via an Umbrella Company or you will be entitled under AWR and also to the workers’ rights listed above.

**Q: As all income paid after 5 April 2020 will be subject to the new rules how can I ensure that payment for all work done prior to 5 April 2020 will be made before the new rules take effect?**

It may not be possible to make payment for all work done before 5 April 2020 before that date, but we will endeavour to make a last payment date for work done prior to 5 April 2020 as close to the 5 April 2020 as possible.

**Q: Will my PSC be at risk of retrospective tax claims by HMRC if the client determines my ongoing assignment as inside IR35 post April 2020?**

HMRC have said they do not intend to make retrospective claims against limited company contractors if they change their status from outside to inside IR35. However, there have been circumstances where retrospective claims have been made against contractors operating in the public sector so we can make no guarantees as to HMRC's future actions.

**Q: What if I disagree with the client's inside IR35 determination of my assignment?**

If the client concludes your assignment is inside IR35 you can ask for reasons and the Client must provide those reasons to you within 45 days. That does not mean the Client is bound to change their determination. You should seek to understand why the assignment you will be, or you are working on has received an inside IR35 status determination. There may be circumstances in which you and the Client can structure your ways of working to put the assignment outside IR35 provided that the structure you put in place is genuine.

However please be aware that the Client has a responsibility to exercise 'reasonable care' when making determinations which means they must ensure that the information they input into an assessment whether through a third-party assessor, CEST or their own in house teams, is accurate and truthful.

**Q: What happens if I still disagree with the outcome?**

If you cannot genuinely structure your ways of working to be outside IR35, then you will have no choice but to accept an inside IR35 determination and the consequent deductions if you want to continue in the role post April 2020. You can appeal your status with HMRC through your tax return, so you should speak to your accountant for more details on going down this route.

**Q: How will this affect future roles?**

Assignments that are genuinely outside IR35 will be unaffected. It is likely that in the future, roles will be advertised as either inside or outside IR35 so there will be clarity from the outset.



## **Q: If I decide to go down the umbrella route, what precautions should I take when choosing an umbrella company?**

There are a number of umbrella companies in the market that effectively offer tax avoidance schemes. These arrangements leave contractors at risk and can lead to HMRC claims for additional tax, National Insurance contributions, interest and penalties down the line.

Signs of tax avoidance schemes include:

- promises to provide the contractor with 80, 90 or 95% take home pay and claims to be tax compliant (this is unlikely to be true as, in most cases, the basic rate of Income Tax is 20% and National Insurance contributions are also due on earnings)
- Only a fraction of the salary is paid through payroll and subject to PAYE (indicating that tax is only paid on some of the income)
- Payments are made using a loan, credit or investment payment and the company claims this isn't subject to income tax or National Insurance contributions (this is tax avoidance)
- The payment from the umbrella company is routed through various companies before it comes to the contractor

It is essential to only work through reputable and compliant umbrella companies and to this end Rullion will only work with FCSA or Professional Passport accredited umbrellas on our preferred supplier list.

# Find out more

[www.rullion.co.uk](http://www.rullion.co.uk)