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Scouting the best contract for you

Contracting Scout's guide to IR35

Are you a contractor struggling to understand the changes happening to IR35 regulations? Contracting Scout can help. Our handy guide tells you everything you need to know and how to stay ahead.

At a glance

6 April 2017 – reforms to IR35 legislation in the public sector became law

10 minutes – we're offering a quick and free consultation to answer any questions

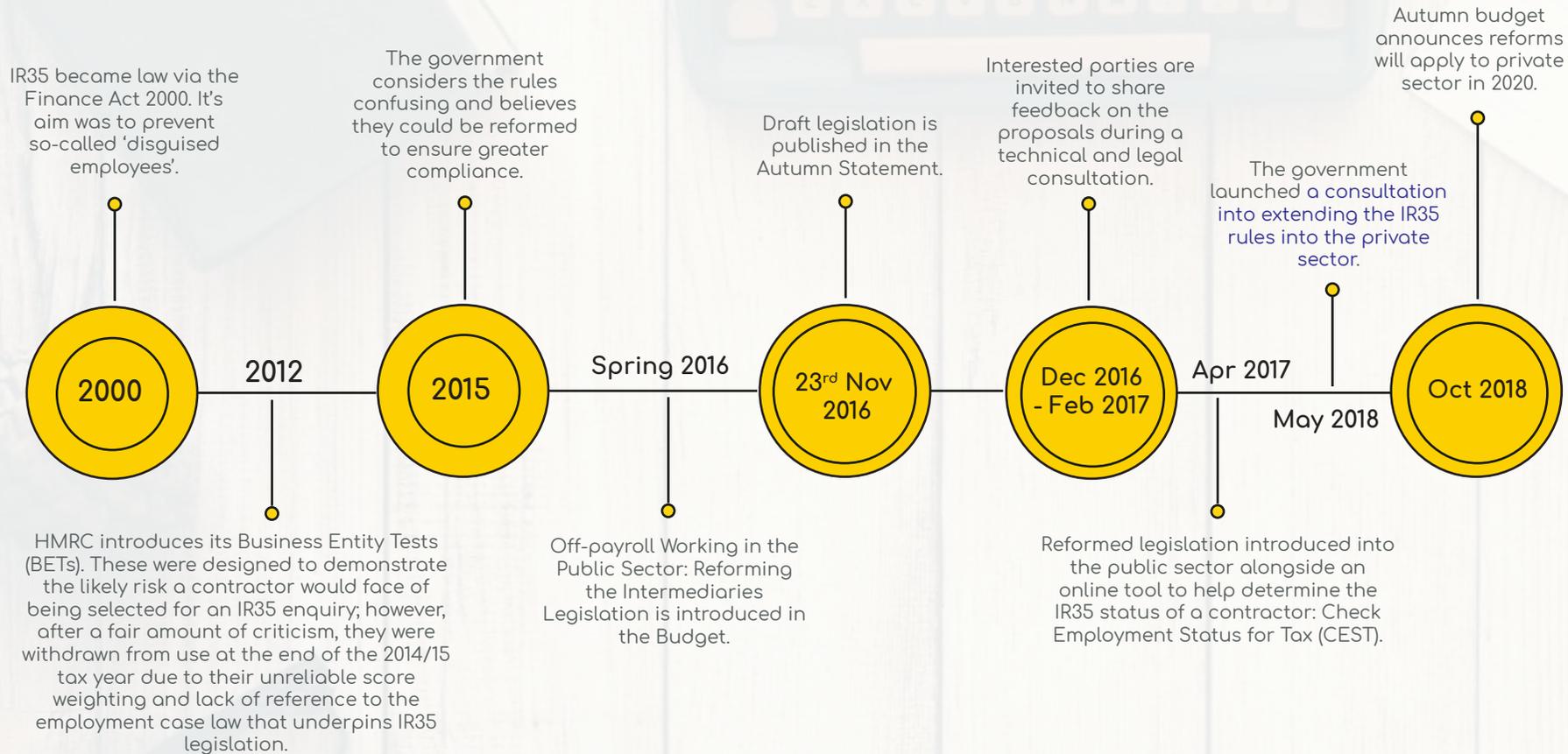
At Contracting Scout, we recognise that contractors play a hugely valuable role in both the private and public sectors – and we want to support you and help you continue to do so.

That's why we've created this IR35 guide, giving you the full background to the reforms and what they might mean for you.

Most importantly, over the next few pages, we'll explain how you can avoid falling into the IR35 trap unnecessarily and how we can help you manage your situation.

The background

Here's a quick run down of how we got to this point,



What is IR35?

IR35 was originally created to stop 'disguised employment'.

Put simply, that means preventing people who are effectively permanent employees claiming to be contractors in order to pay less tax. However, the tests that determine whether or not a contractor falls inside or outside of IR35 are highly subjective and open to interpretation, meaning many genuine self-employed contractors often find themselves at risk of falling foul of HMRC's definition of 'self-employment'.

If it's determined that IR35 should be applied, people working through their own limited companies are required to pay broadly the same tax and national insurance contributions as employees, but their employment status does not change. This means they do not receive the rights and benefits that go with employment, such as employer contributions to a company pension and sick pay.

Inside or Outside IR35

IR35 involves applying three key concepts to determine the employment status on any given contract; these are Control, Substitution and Mutuality of Obligation. These principles examine the way that contractual work is carried out, in order to establish the true nature of the relationship between the hiring organisation and the worker.

1. Control:

what degree of control does the client have over what, how, when and where the worker completes the work?

Most genuine contractors will exercise a high level of control over their work practice. Typically, they need minimal supervision and won't be expected to conform to standard working hours at a designated place of work.

2. Substitution:

is personal service by the worker required, or can the worker send a substitute in their place?

A contractor has the right to send such a substitute in their place and also to engage subcontractors to carry out parts of the contract if necessary. In contrast, a contract that requires the work to be carried out by a specific individual points to disguised employee status.

3. Mutuality of obligation:

is the employer obliged to offer work that the worker is obligated to accept?

Under normal terms of employment there's a mutual obligation for the employer to provide continuous work and for the employee to accept it. This obligation doesn't apply to contractors, who typically work fixed term contracts with a start and finish date. Contractors who regularly work for the same client on new or 'rolling' contracts could be classified as employees under IR35.

How is IR35 being reformed?

The underlying rules used to determine whether someone falls within IR35 will remain the same. What is changing is the responsibility for deciding whether or not IR35 applies based on these rules.

Public sector contractors have previously been able to judge for themselves, often using an IR35 specialist, whether the nature of their work places them within IR35.

In April 2017, IR35 rules changed for public sector contractors, making the client or agency, rather than the contractor, responsible for deciding whether a contract was 'inside' or 'outside' IR35. This will also apply to medium and large* private sector organisations from April 2020.

In both sectors, the hiring organisation will be responsible for deciding the IR35 status of a contract and communicating their decision directly to the contractor via a status determination statement. Responsibility for administering the correct tax and NI deductions will reside with the entity responsible for paying the contractors fees, which will usually be the client or agency.

If IR35 is found to apply to a contract, HMRC can go back at least six years in order to evaluate previous contracts to see if the legislation applies. This means that HMRC can demand income tax and NICs, plus penalties and interest.

Why are these IR35 reforms problematic?

Allowing contractors to decide for themselves whether or not IR35 applies is a common sense approach. This recognised that contractors could be trusted with accurately assessing their own situation and would be able to seek advice on their status if necessary. Research suggests this was working well too – with research from the Public Accounts Committee finding **90% compliance**.

There has been wide spread criticism around HMRC guidance on the new legislation, particularly surrounding the governments's online self-assessment tool CEST. Although the government insist that the reforms have been successful in improving compliance, industry spokespeople have criticised serious discrepancies within the legislation, claiming that CEST is unfit for purpose.

Many public sector contractors responded by exiting the public sector altogether, leaving organisations such as the NHS at risk. Some contractors have said that they will refuse to work under IR35 legislation that classifies them as employees for tax purposes but without any employment benefits.

Despite the negative feedback, the government have done little to address the issues that surfaced in the public sector. Following a consultation into the reforms, the government confirmed that they would apply in the private sector. From April 2020, medium and large businesses will be responsible for making IR35 determination on contracts.

Why are these IR35 reforms problematic?

With an unreliable status determination tool and inadequate guidance from HMRC, many businesses feel unprepared for the changes. Subsequently, many of the top 100 FTSE companies such as Lloyds and Barclays have announced that they won't use limited company contractors.

Although they have stated that the move is a temporary contingency measure to reduce risk, limited company contractors are advised to find an umbrella company in order to keep their options open. With the reform applying to both sectors, limited company contractors could encounter difficulties. Using an umbrella company will ensure that contractors are IR35 compliant by deducting their tax and NICs via PAYE.

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Top tips – how to respond to the changes?

- 1) **Seek advice** – it's important to get advice about these changes as soon as possible, so that you can understand your status and consider your options. Do book in a free ten-minute consultation with us to talk through your options.
- 2) **Stay informed** – keep yourself up-to-date with the changes and the impact these are having. You can subscribe to our newsletter, follow us on social media or check our regular news updates.
- 3) **Gather evidence** – you should keep your original contract, timesheets and invoices. Ideally, this evidence should show you're treated differently to permanent staff – can you demonstrate you bring your own equipment, or that you work on projects with clear end dates?

What are your options if IR35 is applied to you?

- 1) **Appeal** – HMRC released a consultation document making it clear that there will be an appeal process if you disagree with a decision. However many contractors are understandably anxious to avoid any action that risks a full-scale investigation ending in a costly tax tribunal.
- 2) **Process the additional tax liability through your LTD company** – providing you are still allowed to work through your limited company by the hiring organisation, you can calculate what's known as the deemed payment on your limited company and pay the additional tax. You may benefit from the services of a specialist accountant.
- 3) **Switch to umbrella** – Setting up an umbrella company wouldn't change your tax liabilities, but it would mean that you're able to gain employment rights, such as holiday pay and pension contributions.
- 4) **Third party solutions** – Some accounting firms are offering innovative solutions in which they assume the risk of determining IR35 status on the engager's behalf. If this is of interest, please get in touch as Contracting Scout is able to offer access to these providers.

How can we help?

Here at Contracting Scout, we're fully committed to supporting contractors. We created this guide because we understand these reforms could be concerning for many – and we want to do all we can to help contractors respond to these changes.

We don't expect to answer every single question you might have in this guide and we realise you might need advice that takes account of your personal circumstances.

That's why we're offering a completely free 10-minute consultation to anyone worried about the new rules.

Our Scout representatives will be able to look at the potential impact of the reforms to your take home pay and discuss a number of options to help you get the most from contracting.

If this is of interest, simply [get in touch with us](#).

And, if you need more information, you can keep up to date as the legislation comes into force on our [Twitter](#) or [LinkedIn](#) pages, or sign up to our newsletter at the bottom of our [home page](#).

***Medium and large companies are those that:**

- turnover more than £10.2m
- have a balance sheet total of more than £5.1m
- and employ more than 50 people