# Umbrella Exchange IR35 Guide

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Recent changes to this complex legislation have resulted in considerable confusion and upheaval for contractors. With further reform coming into effect from April 6th, it's crucial that contractors keep themselves up-to-date on all developments and how they might be affected by them. Our guide to IR35 will give you a concise, yet comprehensive, overview of this important set of regulations.

## An overview of IR35

IR35 is a tax law announced in 1999, which took effect from April 2000 as part of the Finance Act. Formally known as the **Intermediaries Legislation**, IR35 was introduced to prevent people who are effectively permanent employees working through an intermediary (a **limited company** or **personal service company**) in order to pay less tax.

Although the legislation has a legitimate role to play in defending both workers' rights from unscrupulous employers and HMRC from lost tax revenue, critics of IR35 have claimed that the legislation is confusing and poorly implemented by **HMRC**.

When working under the legislation, contractors are expected to pay the same taxes as employees, but without any of the safety, security or statutory benefits that employment brings.

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.

The reforms led to some public sector organisations announcing a blanket decision not to hire contractors working through limited companies, in order to ensure IR35 compliancy. Many contractors responded by exiting the public sector altogether, leaving organisations such as the NHS at risk. Despite widespread opinion that HMRC's online assessment tool, CEST, is not fit for purpose, the government confirmed that the legislation would be rolled out to medium and large private sector firms in April 2020. **The date for implementation was subsequently put back from April 2020 to April 2021 following the Covid-19 outbreak**.

This means that private sector businesses will be responsible for deciding if IR35 applies to each contract. Faced with an unreliable assessment tool and inadequate guidance, **many businesses have taken measures to reduce their liability risk by introducing a ban on limited companies ahead of the reforms**.

Although an Off-Payroll Review concluded that the reforms had been a success, a subsequent House of Lords Inquiry contradicted this verdict. The Lords Inquiry found evidence of both widespread non-compliancy and subsequent damage to multiple sectors.

## IR35 Facts

- Introduced in April 2000.
- Reforms to public sector contracts in April 2017
- 2018 autumn budget announces reforms will apply to private sector in 2020
- Government publish draft off-payroll legislation July 2019
- Off-Payroll Review Launched Jan 2020 in response to criticism
- Businesses adopt widespread bans on PSCs, forcing contractors onto the payroll to avoid liability for making assessments
- **Off-Payroll Review verdict says reforms are necessary** and will go ahead, March 2019
- **The House of Lords launch a sub-committee inquiry** into the reforms, finding widespread evidence of damage and non-compliancy, March 2019
- **March budget confirms off-payroll legislation will go ahead** with ‘soft landing’
- Government announce the reforms will be delayed until April 2021 in response to the Covid-19 outbreak
- If you are caught inside IR35 you will be deemed to be an employee and subject to full PAYE and NIC
- Applies to the individual contract, not the contractor
- Seek professional advice to ensure you understand your risks

## 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.

## How do the new rules work?

IR35 reform introduces a transferal of liability that enables HMRC to collect outstanding tax from other parties in the supply chain. The tax liability will initially rest with the party that failed to carry out their compliance obligations. If HMRC cannot recover the liability from them, they will move to the first agency in the supply chain. If they are unable to recover the unpaid tax from them, they will move to the end-client.

**1. Client assesses status:** Before the contract starts, the end-client will assess what the contractor’s status will be while working on that contract. Sometimes the status will be included in the job advert.

**2. Status determination statement:** The end-client must provide the contractor with a '**status determination statement**' stating whether or not they believe IR35 applies and the reasons why. This will also be passed along the supply chain to the fee-payer. Until the client fulfils this obligation, they will be classed as the fee-payer and held liable for any unpaid tax.

**3. Disagreement process:** If a contractor or fee-payer disagrees with an IR35 decision, they can raise this directly with the end-client who will have 45 days to consider and respond. If the end-client fails to do this, they will then become the fee-payer, meaning that the IR35 liability will transfer to them.

**4. Fee-payer makes necessary deductions:** If you are inside IR35 the fee-payer (usually your recruitment agency) will be required to deduct the relevant tax and National Insurance contributions (NICs) before paying you. Some agencies/clients may instead require contractors to engage via an umbrella company or outsourced alternative arrangement due to payroll complications.

## How can contractors safeguard themselves?

HMRC have stated their expectation that people take 'reasonable care' to comply with the tax regime. Demonstrating reasonable care could include the following:

**Keep your paperwork in order:**
Keeping organised and comprehensive records relating to your assignments will help contractors to file detailed and accurate self-assessment tax returns. In the event that HMRC decides to raise an inquiry, these records could provide invaluable evidence.

**Check your contract:**
A contractor should always take the time to read over their contract before signing it. Wherever possible, contracts should include a **right of substitution clause** stating the contractor's right to send a substitute in their place or to engage a subcontractor.

**Communicate with your agency and/or client:**
Open communication is increasingly important between all parties who are negotiating the contract to ensure that all are in agreement regarding the contractor's employment status.

**Consider a confirmation of arrangements letter:**
Where an agency or client uses a generic contract, contractors can use a confirmation of arrangements letter, which asks the client representative to confirm the most important points about their contract and working arrangements.

**Seek professional advice:**
When in doubt, contractors should seek professional advice and consider a contract review service for each assignment.

**Avoid acting like an employee:**
When determining employment status, HMRC examines the day-to-day activities of the contractor. In order to differentiate themselves, contractors should avoid typical employee behaviour, such as always eating in the staff canteen or accepting benefits such as sick pay or holiday pay from the client.

HMRC offers a **self-assessment tool** to help contractors decide if IR35 applies.

**HMRC has stated that they will not carry out targeted campaigns into previous years unless they have reason to believe there is fraud or 'criminal activity'. However, this leaves HMRC with a broad remit under which to investigate, so exercising due diligence is essential.**

## What to do when IR35 applies

Contractors who fall inside IR35 will be required to have PAYE and NICs deducted at source from their income. The responsibility for making these deductions will fall to the fee-payer, which will usually be the end-client or the recruitment agency. If you are determined as inside IR35, the fee-payer will deduct the relevant tax and NICs from your fee (net of VAT) before making payment to your limited company.

Another option is to join a **compliant umbrella company**. The umbrella company becomes the contractor's employer, paying them through PAYE. Due to the ongoing working arrangements, agencies are more likely to suggest the umbrella company option for contractors. To find out if an umbrella company would suit your needs, **read our guide here**.

## Expenses

When you are assessed as inside IR35, you will no longer be entitled to the 5% expense allowance previously provided when calculating a deemed direct payment

- You also cannot claim for any expenses relating to travel and subsistence when operating inside IR35
- You can still deduct any employer pension contributions from your business profits, reducing your Corporation Tax bill

Keep updated with IR35 developments through our latest **news** articles.

**At Umbrella Exchange we can offer you an IR35 solution to suit your personal circumstances. We have access to an excellent range of specialist umbrella companies, and can also help you with suspending or closing your limited company, depending on your situation. If you've been affected by the IR35 reforms and feel unsure about your position, get in touch with us and we'll talk you through your options.**

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