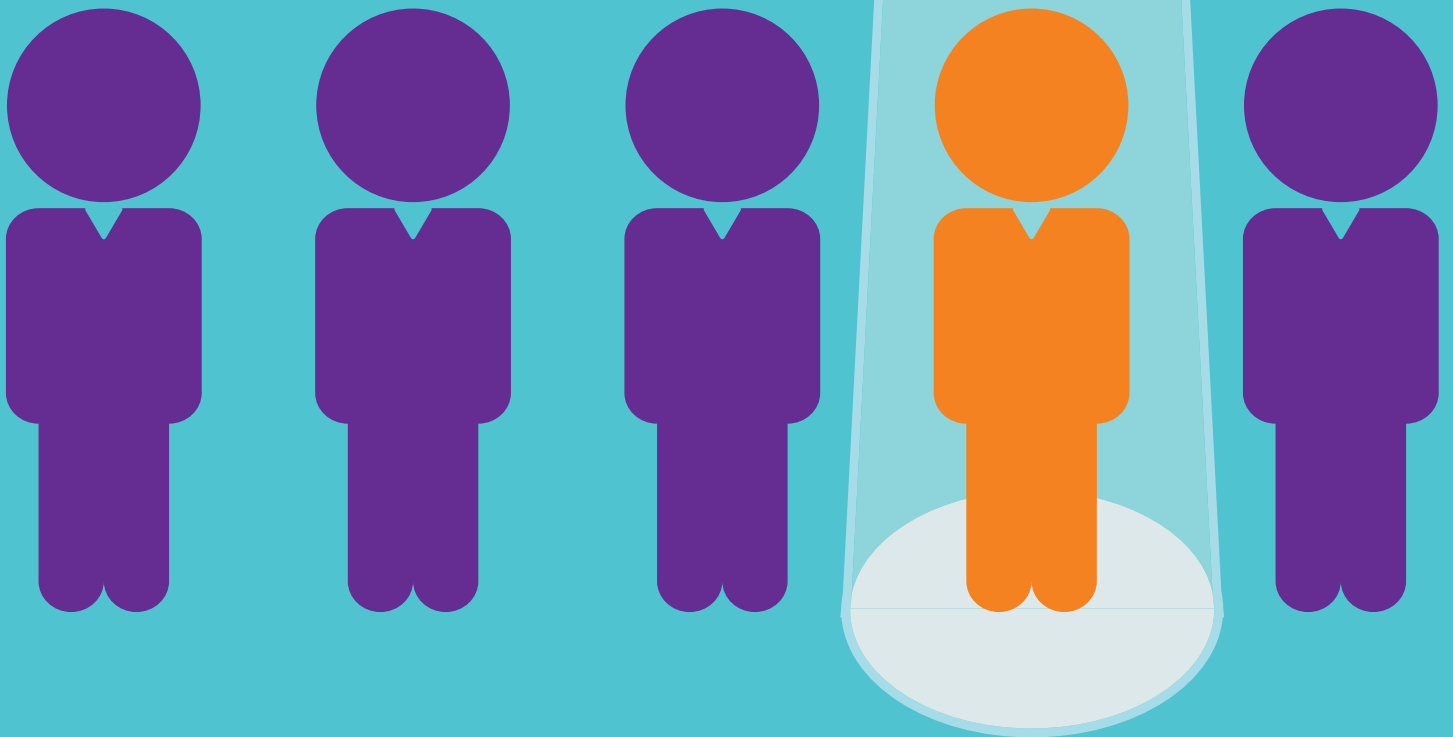


IR35 Guide

A comprehensive guide to off payroll working and how it will affect employers



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Welcome to our guide on IR35, otherwise known as off payroll working. Here are the topics that we will be covering.

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The History of IR35

What is the origin of this legislation?

IR35 was originally defined when HMRC, or Inland Revenue as they were known at the time, issued a press release in 1999 that looked to address the tax advantage that legislation at the time allowed workers who engaged with an employer through an Intermediary.

At the time workers were required to provide a self-assessment of their employment status and therefore eligibility for IT and NIC contributions. HMRC underestimated the number of workers that would complete this assessment and declare themselves inside IR35 and therefore new legislation was released to switch the responsibility for assessment from the worker to the engager. Known as the Intermediaries legislation, this was approved, enacted and became law from the 6th of April 2000.

Definition of an intermediary :

An Intermediary is defined under one of four categories.

- 1) Limited Company - a separate legal entity. The company is responsible for its legal tax and affairs. The worker is either a director or shareholder or both and an employee.
- 2) Umbrella Company - this is used when a worker doesn't want to set up their own Ltd Co. The Umbrella Company is responsible for operating PAYE and NIC on payments to the worker. The invoice you received would be from the Umbrella.
- 3) Sole Trader/Self-Employed - this is not covered by IR35. Normal employment status applies and if deemed to be employed PAYE and NIC applies but the worker also has full employment rights unlike in the case of IR35.
- 4) Partnership - this is the same as a sole trader but can be caught by IR35 legislation. The worker and spouse worker do all the work, a 'contrived partnership.'

What is IR35?

Now we know where the legislation was derived from, what does it mean?

IR35, otherwise known as off payroll working, is essentially deemed employment status. It addresses the issue of Contractors working through their own Intermediary having a tax advantage over other employed workers.

Up to the 5th of April 2017 legislation dictated that workers would self –assess whether they were caught by IR35 or not, but HMRC underestimated the number of workers that would deem themselves to fall inside IR35 and therefore the treasury did not receive the amount of tax receipts that was expected.

IR35 poses the question of employment status - in other words, but for working through their own intermediary would the worker have been an employee of the engager?

If they would have been this would fall under IR35 and therefore they would have to operate PAYE and NIC on the payments that they/their Personal Service Company received from the engager.

2017 Update to the Public Sector

From the 6th of April 2017 legislation was introduced to the Public Sector to target losses of tax and NIC by the HMRC/Treasury.

In response to losses of tax and NIC that were identified by HMRC and the Treasury, legislation was introduced in April 2017. The update was first rolled out to the public sector and saw the responsibility for the assessment move from the worker to the engager. The engager is also required to pay HMRC employers NIC at 13.8%. The gross amount assessed for PAYE must be included in any Apprenticeship Levy Calculation.

The reasoning for this is that it was deemed that the engager would be more likely to re-assess the worker than the worker themselves, if a threat of penalties was made. Workers were also less likely to deem themselves to fall under IR35 to avoid having to pay the regular tax and NIC charges.

Although it is referred to as deemed employment the IR35 changes do not confer employment right to the worker therefore meaning no holiday pay, pension auto-enrolment, maternity, paternity or other statutory payments.

From the 6th of April 2020 two more changes will apply to IR35 within the public sector.

From the 6th of April 2020 legislation introduces two main changes to IR35 within the public sector.

- 1) The engager must provide the worker with the results of the employment status determination and the reasons for the determination.
- 2) The worker will then have 45 days from the date of the determination to raise an appeal which needs to be lodged directly to the engager.

The engager will review the appeal and notify the worker of the outcome. If the worker is still not happy, the worker will need to contact HMRC.

April 2020 Changes to the Private Sector

Following the ‘success’ of Off Payroll Working within the Public Sector, the 6th of April 2020 sees the introduction of IR35 into the Private Sector.

The success of IR35 in the Public Sector may be debatable, but HMRC are ploughing on to roll out Off Payroll Working to the Private Sector this April.

It will only apply, however to medium and large companies, for small companies the responsibility of assessment will still fall with the worker.

How are small companies defined?

A small company is defined as meeting any of the following two conditions within a 12 month period. If they do not meet the criteria of a small company, they will be classed as a medium or large company and will be liable for assessing their off payroll workers.

- 1) Turnover - no more than £10.2 million
- 2) Balance Sheet total - no more than £1.5 million
- 3) Number of employees - no more than 50

As with the Public Sector, the engager must provide the worker, and if any Agencies are involved the Agencies, with the employment status determination result and reasoning. The worker will have 45 days to lodge an appeal against the determination which as with the Public Sector is to be raised with the engager who must take the appeal up with the HMRC.

The IR35 Assessment

How can an IR35 assessment be carried out?

To carry out the IR35 assessment the HMRC made updates to their CEST (Check Employment Status for Tax) tool which our own Paul Chappell, Head of Legislation & Compliance was involved with testing. The updates were released in November 2019.

Although as Paul discovered the CEST tool is not entirely fit for purpose as it does not consider Mutuality of Obligation, it is a significant improvement on its predecessor.

In the Ready Mixed Concrete 1968 Employment Tribunal case three criteria were set out for considering employment which were:

Mutuality of Obligation

If there is no obligation on either side to offer and accept the work there cannot be employment.

Substitution

If the worker can legitimately send a substitution (verbally or contractually) there can be no employment.

Control

What control does the engager have over the how, where, when, what and why work is done? If there is no control there can be no employment.

Accessing the CEST Tool

The revised CEST Tool can be accessed [here](#)

There must be a contract in place to see whether the engagement is classed as employment or self-employment. The tool assumes there will be one in place.

CEST Outcomes

The CEST tool will deliver one of three outcomes.

HMRC assure us that the CEST tool remains anonymous, although there is a facility to enter personal details if required, and in at least 90% of cases it will provide a definitive outcome of whether employment or self-employment applies.

The three possible outcomes are:

‘This engagement should be classed as employment for tax purposes.’

In this case IR35 applies.

‘This engagement should be classed as self-employment for tax purposes.’

In this case IR35 does not apply and the invoice can be paid in full.

‘Unable to determine the status of the engagement, contact HMRC.’

Our advice is to consult with an expert first.

The tool bases the results on the answers that are provided, and in the case that no determination can be made it will direct the user to contact the HMRC’s specialist helpline. Our advice would be not to contact the helpline as they are much more likely to rule in favour of IR35 applying! Our recommendation would be to contact an expert professional (consultancy services are available at Dataplan) in the first instance.

Remember, the responsibility for assessing IR35 status now lies with the engager and it is the engager who will lose out if IR35 is ignored or applied incorrectly and penalties are charged. You are likely to come up against resistance from the worker who will be used to assessing themselves outside of IR35 and therefore outside of PAYE and NIC.

If the assessment has been made in good faith and with reasonable care based on full information going through the CEST tool then HMRC will honour the determination – there is no guarantee that this will not change in the future though.

In the case of [Richard Alcock](#) (RALC Contracting) HMRC ignored the assessment which was heavily criticised by the Tax Tribunal. The assessment from CEST does therefore carry weight and should be used by all engagers.

Making Payment to the Worker

How should you go about making payment to the worker, in the case that they fall inside or outside of IR35?

Depending on the outcome of the CEST process, the worker should be paid accordingly.

Outside of IR35

If the worker is deemed to fall outside of IR35 then the invoice should be paid in full as you would any other invoice that you receive.

Within IR35

If the worker is deemed to fall within IR35 you should exclude VAT from the invoiced amount (if appropriate) and the remaining balance will be chargeable to PAYE and NIC.

Tax is charged at the Basic Rate, until and unless HMRC advise otherwise and issue the worker with a new tax code. You should calculate and pay over the Employers NIC. This deemed salary counts towards Apprenticeship Levy but does not qualify for Employment Allowance.

IMPORTANT

When the worker leaves do not issue a P45, unless HMRC have provided you with a revised tax code to use. If this is not the case and they are at the basic rate at the tax year end they should be issued with a P60.

IR35 Liabilities & Penalties

What are the penalties of not getting it right?

If an IR35 assessment has not been done or has been done incorrectly then HMRC will look to recover PAYE and NIC in addition to a penalty and interest for late payment, if they deem that IR35 should have applied.

If an IR35 assessment has not been done or has been done incorrectly it can be expected that the HMRC will expect to recover the liability in addition to a penalty and fines for late payment.

The liability that HMRC will recover will be the original invoice amount, a straight 20% tax, NIC (taking into account the primary threshold which is currently £719) at 12% and employers NIC at 13.8%.

Note :

Example where the engager has been invoiced £2,500 by the worker

Example Invoice	Tax at 20%	Amount eligible for NIC	Employees NIC at 12%	Employers NIC at 13.8%	Worker Payment	Total Engager pays
£2,500	£500	£1,781	£213.72	£245.77	£1,786.28	£2,745.77

HMRC Penalties

In the case of IR35 the HMRC will consider behaviours that have led to the failure to consider off payroll working when looking at penalties. The four criteria that they will consider are:

1) Reasonable care

According to the HMRC if reasonable care has been taken but a wrong decision arrived at a penalty will not be pursued. This could be the case if for example incorrect information was provided by one of their helplines as care would have been taken to contact them but incorrect advice was given.

2) Careless

HMRC refer to careless as not taking reasonable care (not a very clear definition.) In this case if an error or mistake has led to an underpayment of tax and, using the CEST tool incorrectly, HMRC may consider a penalty but will look for conditions to be set and suspend the penalty.

3) Deliberate but not concealed

In this scenario deliberate but not concealed means that PAYE has not been operated despite the use of the CEST tool delivering an outcome of IR35 applying. Despite using the tool the engager has not tried to conceal the outcome.

4) Deliberate and concealed

This would be classed as the most serious offence. In this case the engager would be aware that PAYE should have been applied but concealed the payment to the worker, perhaps by creating a false invoice.

The penalties for the four criteria are as follows.

Reasonable Care	Careless	Deliberate - Not Concealed	Deliberate - Concealed
No penalty	0-30% of the tax & NIC liability but can be suspended if HMRC can set out conditions for future compliance	20-70% of the tax & NIC liability	30-100% of the tax & NIC liability

Each criteria has a range of abatements taking into consideration the quality of disclosure that is made. The reduction ranges are as follows.

Telling	Helping	Access to Records & Information
Up to 30%	Up to 40%	Up to 30%

If full assistance is given to them in a deliberate but not concealed case the penalty will be 20% as the full 100% reduction will be given.

In Summary

In short, IR35 can be described as follows.

- IR35 is described as deemed employment status
- It applies in any situation within the public sector, and to all medium and large companies within the private sector where an intermediary is involved in the engagement between a company and a worker
- Intermediaries are defined as limited companies, umbrella companies, self-employed/sole traders and contrived partnerships
- It is the engagers responsibility to assess whether IR35 applies, unless the engager is a small company in which case responsibility lies with the worker for self-assessment
- HMRC have an online CEST tool to help assess whether off payroll workers fall within or outside of IR35
- The CEST tool provides three outcomes which are inside IR35, outside IR35 and that an outcome cannot be reached and to contact their helpline (we advise against this and recommend contacting an expert like our Head of Compliance & Legislation Paul Chappell instead)
- If IR35 has not been considered or has been applied incorrectly HMRC will look to recover liability, penalties and a fine for late payment
- Liabilities are calculated by looking at the invoice amount. Tax is deducted at the basic rate of 20%, and NIC deducted at 12% on all payments above the Primary Threshold. Employers NIC is also payable at the rate of 13.8% above the Primary Threshold.
- HMRC will consider behaviours when setting out penalties when IR35 has not been considered or applied incorrectly which dictate the scale of fine
- The criteria are reasonable care, careless, deliberate but not concealed and deliberate and concealed
- Reasonable care carries no penalty, careless carries a penalty of 0-30%, deliberate but not concealed carries a penalty of 20-70% and deliberate and concealed carries a penalty of 30-100%
- HMRC will make reductions in penalties based on levels of cooperation which are up to 30% for telling, up to 40% for helping and up to 30% for providing access to records and information

Find out more

If you have any questions or concerns regarding IR35 you can contact our expert team for advice.

If you have any questions or concerns regarding IR35, or you have completed the online CEST tool and have not been delivered a definitive assessment we are able to offer a range of consultancy services to assist you.

Our Head of Compliance & Legislation Paul Chappell has extensive experience in dealing with the HMRC, assessing working status and representing clients at Tax Tribunals.

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