

IR35 Reforms in the Public Sector

How damaging were the reforms?

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Introduction and Background

The Government introduced legislative changes to IR35 in the public sector from 6th April 2017.

The proposals prompted widespread concern, both in their objectives and workability, with expert commentators warning of the damage that public sector projects would suffer due to increased costs, combined with an exodus of contracting talent from the public to the private sector.

In a ContractorCalculator poll in July 2016, to understand the likely behavioural effects of the proposals, 80% of contractors said they would quit working for the public sector.

This survey of c1600 contractors and permanent staff working in the public sector was used to find out what happened after the reforms were introduced.

Executive Summary

The omens didn't look good prior to the implementation of the reforms. Besides the questionable changes themselves, there was uncertainty within the public sector, a lack of awareness and even a lack of readiness on HMRC's part. As the results of this survey show, and as many experts predicted, what has transpired is **a public sector drained of talent and resources**, struggling to stay afloat without the flexibility it requires.

In total, the public sector lost more than a quarter of its contracting workforce after 6th April, with departments hiring IT, healthcare and project management professionals proving the biggest casualties. This exodus of talent affected three quarters of projects, with **24% of departments losing at least half of their contractors**.

A refusal to work under conditions that are caught by IR35 was the key driver behind the decision of most contractors, who departments are struggling to replace. Major **consultancies have only managed to fill 15% of vacancies**, whilst **more than half of exiting contractors are yet to be replaced**.

Attempts by organisations to impose blanket rules and force contractors into umbrella companies have yielded mixed results. A third of contractors who remained in the public sector moved to an umbrella company, yet the prospect of working under an umbrella arrangement **prompted a significant number to leave the sector**.

The **impact on public sector projects has been disastrous**. Diminished access to the flexible workforce has caused damage to multiple vital public services; healthcare, police and public transport to name a few. This is in addition to Government projects and, ironically, HMRC's Making Tax Digital regime which has reportedly been pushed back by roughly six months as an indirect result of the reforms.

Delays to projects and services is a concurrent theme. Our findings show that **seven in ten projects suffered delays** as a result of contractors leaving. Elsewhere **projects are being cancelled altogether**, whilst others are experiencing cost overruns extending into millions of pounds.

Of the contractors who remained in the public sector, 44% managed to continue working on an outside IR35 basis. IT contractors and project managers fared relatively well in this regard, making up the bulk of this number. However, contractors working for the NHS and in health and social care haven't been so fortunate.

Some public-sector departments have managed to cling onto their valuable flexible workers by increasing contract rates. This itself is counterproductive, as it effectively means **the public sector itself is footing the additional tax bill**. Nonetheless it is keeping some contractors in the public sector.

Due to the pay caps in place for the likes of the NHS, many locum doctors and nurses are currently being remunerated way below their market value, after tax. The effect on morale is evident. **63% of contractors working in the NHS and healthcare are considering changing career because of the reforms, whilst 40% may quit contracting.**

Unless urgent action is taken, this looks set to exacerbate an already acute problem. Anecdotal evidence shows that **operations are being cancelled, cancer waiting times are being extended** and patients with mental health conditions are being left without support due to staff shortages.

We also saw evidence that the **reforms have restricted the mobility of flexible workers in the public sector**. Difficulties accessing travel and subsistence tax relief meant for many contractors travelling long distances to work was no longer financially viable. In turn, projects lost out on further valuable expertise.

It is not only the reforms themselves that have caused chaos in the public sector, but also their implementation. Qualitative data suggests that many public-sector organisations are still unsure about their compliance requirements, whilst others are simply neglecting their responsibilities. Many **contractors are placing the blame squarely at the feet of HMRC**, citing a lack of communication and preparation on the taxman's part as the causes of confusion.

Any suggestion that the reforms are merely going through a teething period don't carry much weight when you consider the direction of the contract sector. **50% of contractors claim they will never work a contract in the public sector that is caught by IR35**, whilst the red tape has proven enough to deter 20% of contractors from working in the public sector altogether.

Summary of findings

Contractors abandon the public sector

- 27% of contractors working in the public sector left the sector after the reforms went live
- 76% of projects/departments lost contractors due to the IR35 reforms
- Skills exodus led by IT (48%), NHS/Health (29%), and Interim and project management (28%)

The damaging effect on projects/departments

- 47% of projects/departments lost at least a quarter of their contractors due to the IR35 reforms
- 38% of contractors could not be replaced
- 71% of projects were delayed because of the contractors leaving

Why contractors stayed or left

- 61% left citing they refused to work on an inside/caught by IR35 basis
- 44% who stayed could carry on working on an outside IR35 basis
- 32% moved to using an umbrella company
- 13% received rate rises

The future of contractors in the public sector

- 50% of contractors will never work in the public sector if caught by IR35
- 46% will only do so if the Government effectively pays the extra tax
- 20% of contractors have now ruled out the public sector entirely as a place to work
- 17% are quitting contracting due to the reforms
- 39% are considering changing career

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Commentary by Dave Chaplin, CEO of ContractorCalculator

Dave Chaplin is an expert on contracting and IR35. He founded ContractorCalculator.co.uk in 1999, the UK's leading resource for contractors and freelancers, visited by over 150,000 contractors each month. He is also author of two books - the Contractors' Handbook and Beat IR35.



HMRC was warned that this would happen. Not just by us, but by stakeholders across the contracting sector. This is economics 101. The taxman knew the market would adjust to the changes. What HMRC didn't know was how damaging those adjustments would be.

There has been chaos. We've heard of delays, cancellations and projects elsewhere that have gone over budget by millions of pounds – far from the intended consequences that HMRC had in mind.

This couldn't have come at a worse time either. With Brexit and other challenges right around the corner, HMRC has chosen now to shoot the public sector's IT capability in both feet by sparking a contracting exodus. Government projects are in dire straits, but IT expertise is not the only resource the public sector is starved of. We can't underestimate the impact of the changes on public healthcare, nor the aggravating effect the changes have had on departments in need of project managers.

HMRC has left itself between a rock and a hard place. The only logical option would be to repeal the reforms, but we know HMRC isn't in the habit of acknowledging its failures. Since the reforms, many have pointed out that a two-tier tax system is unfair and unsustainable, and I would agree.

The fear is that HMRC will choose to 'level the playing field' with a private sector rollout of the reforms. This would be incredibly damaging, and HMRC would be crazy to do so. But as the public-sector reforms demonstrate, you can never underestimate how far removed from reality the taxman can be.

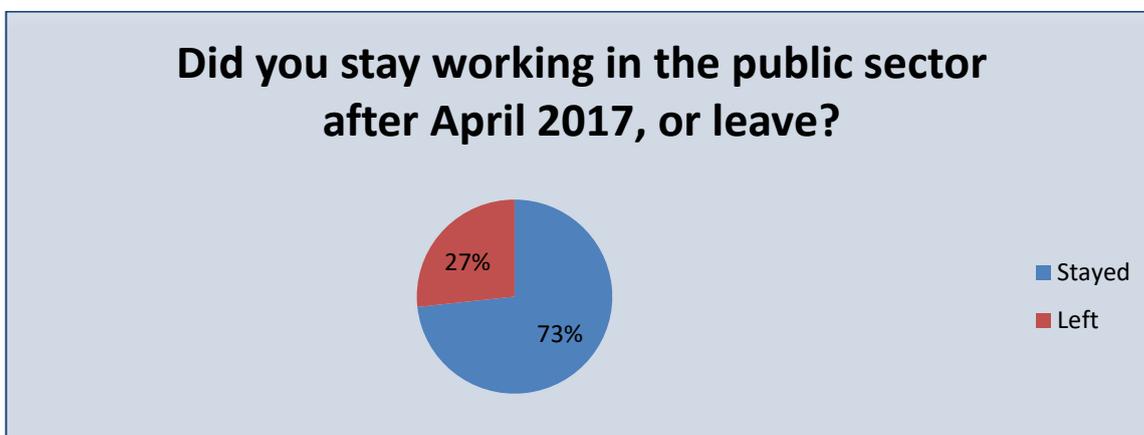
The best that contractors can realistically hope for is that HMRC decides to turn a blind-eye to the reforms. Anecdotal evidence suggests that this is already happening, with one of our respondents noting that HMRC is already relaxing its own rules!

Regardless, the taxman has 19 years of failing to effectively enforce the unenforceable legislation that is IR35. But that isn't to say contractors can rest on their laurels. Investigations will happen and HMRC inspectors will pick the low hanging fruit. As always, the advice to contractors is the same – get your ducks in a row. Check your working practices first, then make sure the paperwork aligns with it. Ensure that, if an HMRC inspector comes knocking, you're ready to shut them down.

The public sector lost 27% of its contractor workforce after the reforms went live

Contractors caught by IR35 had to decide whether to continue working in the public sector or leave:

- Overall, 27% of contractors decided to leave
- Key sector breakdown of those leaving: IT (37%), management (29%), NHS / Health (20%)

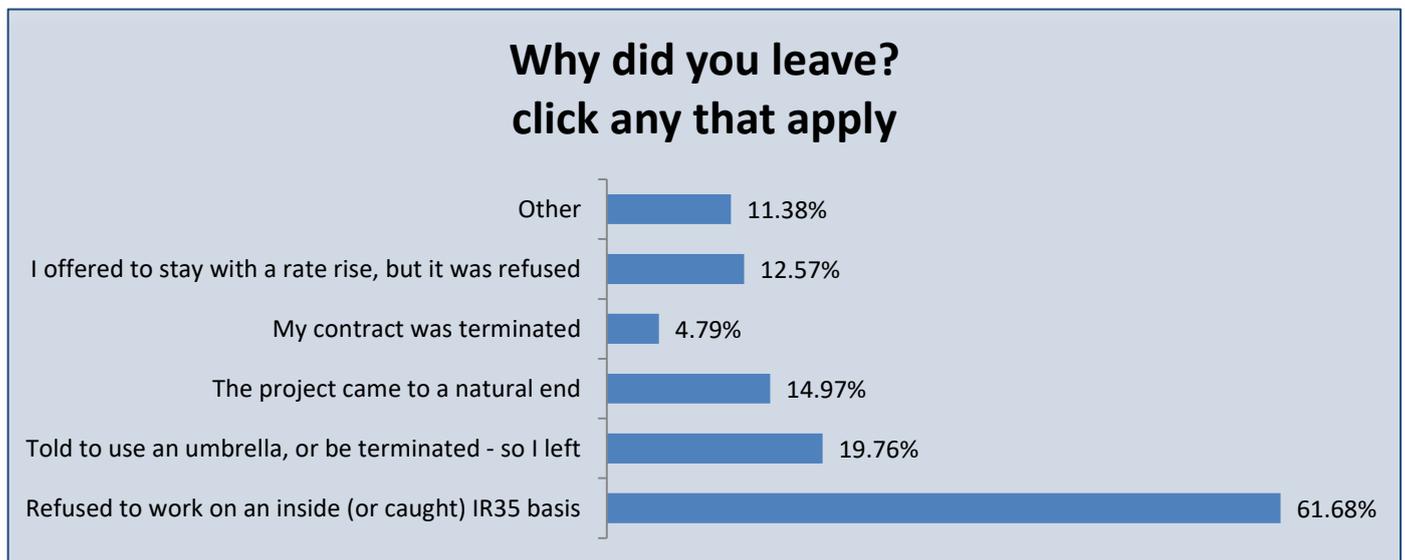


Prior warnings of an exodus of contractors came true, as 27% left the public sector.

Why did they leave? 61% refused to work on an inside/caught by IR35 basis.

By leaving the public sector, these contractors avoided being caught by IR35 and treated as deemed employees:

- 61% refused to work on an inside IR35 basis – so left
- 19% were told they must move to using an umbrella, and refused and left

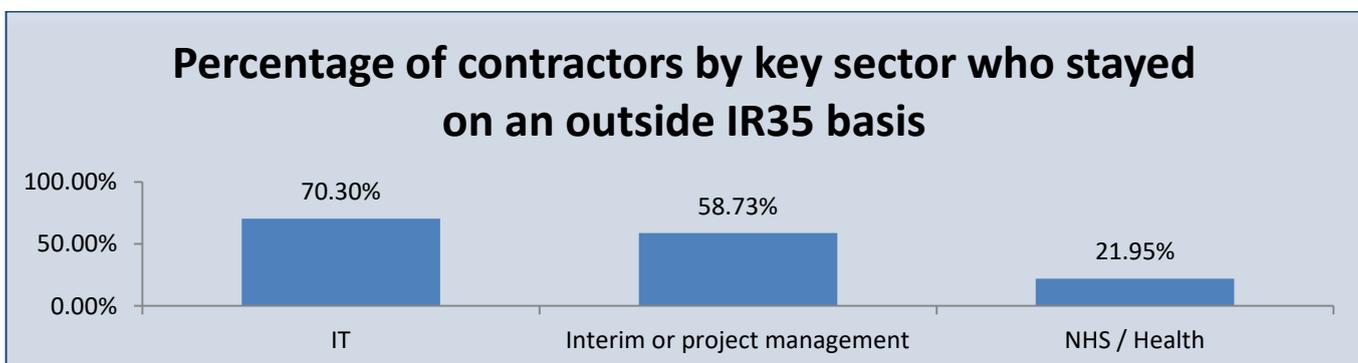
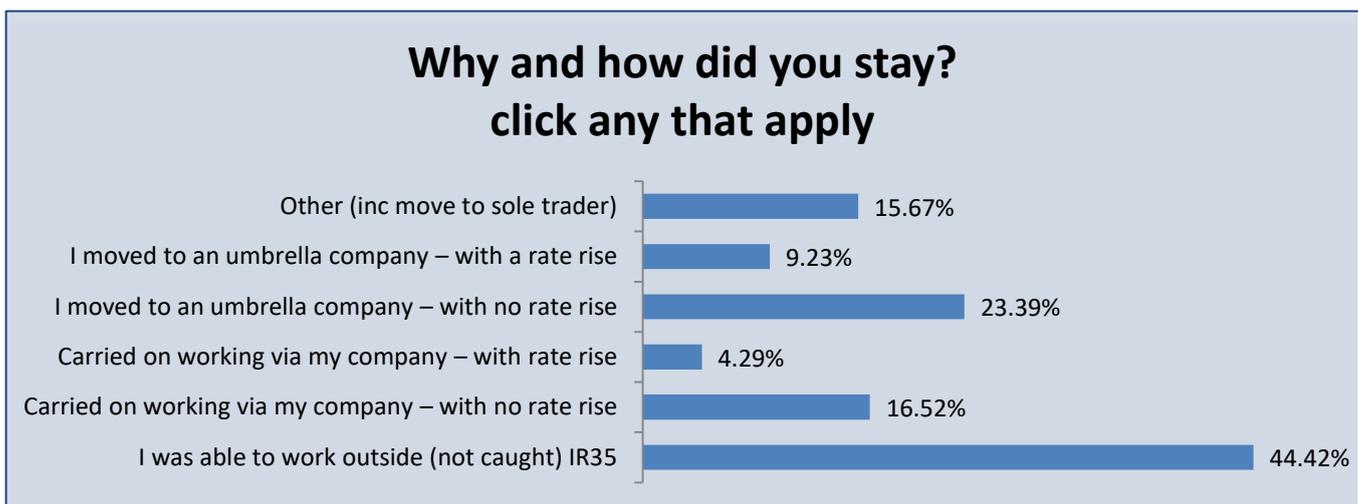


61% of contractors who left the public sector did so because they refused to work as deemed employees caught by IR35.

44% carried on working on an outside IR35 basis. But NHS / Health professionals suffered the most.

Some contractors managed to carry on working outside of IR35:

- Overall, 44% who stayed could carry on working on an outside IR35 basis
- 32% moved to using an umbrella company
- 13% received rate rises, meaning the public-sector body effectively paid the extra tax
- Carried on the same outside IR35 by sector: IT (70%), management (58%), NHS / Health (22%)



Sectors experienced varying fortunes – with NHS / Health being worst affected.

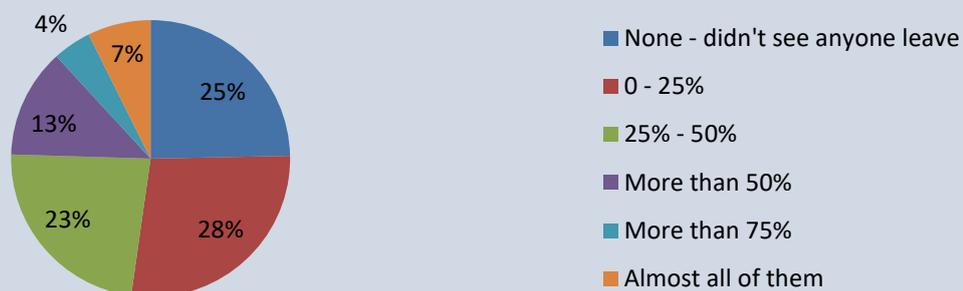
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Three in four projects/departments lost contractors due to the IR35 reforms

Most projects or departments lost contractors, and IT was very badly hit.

- 24% said that their projects did not lose any contractors
- 47% of projects/departments lost at least a quarter of contractors
- 24% of projects/departments lost at least half their contractors
- 7% to 9% lost almost all of them
- Lost more than half their contractors: IT (27%), Interim management (31%), NHS/Health (25%)

In the department/area or project you were working on how many contractors left because of the IR35 reforms?



How many left?	IT	Management	NHS / Health
None - didn't see anyone leave	16.05%	30.23%	16.34%
0 - 25%	29.01%	23.26%	29.41%
25% - 50%	27.16%	15.12%	29.41%
More than 50%	14.81%	17.44%	10.46%
More than 75%	3.70%	4.65%	5.88%
Almost all of them	9.26%	9.30%	8.50%

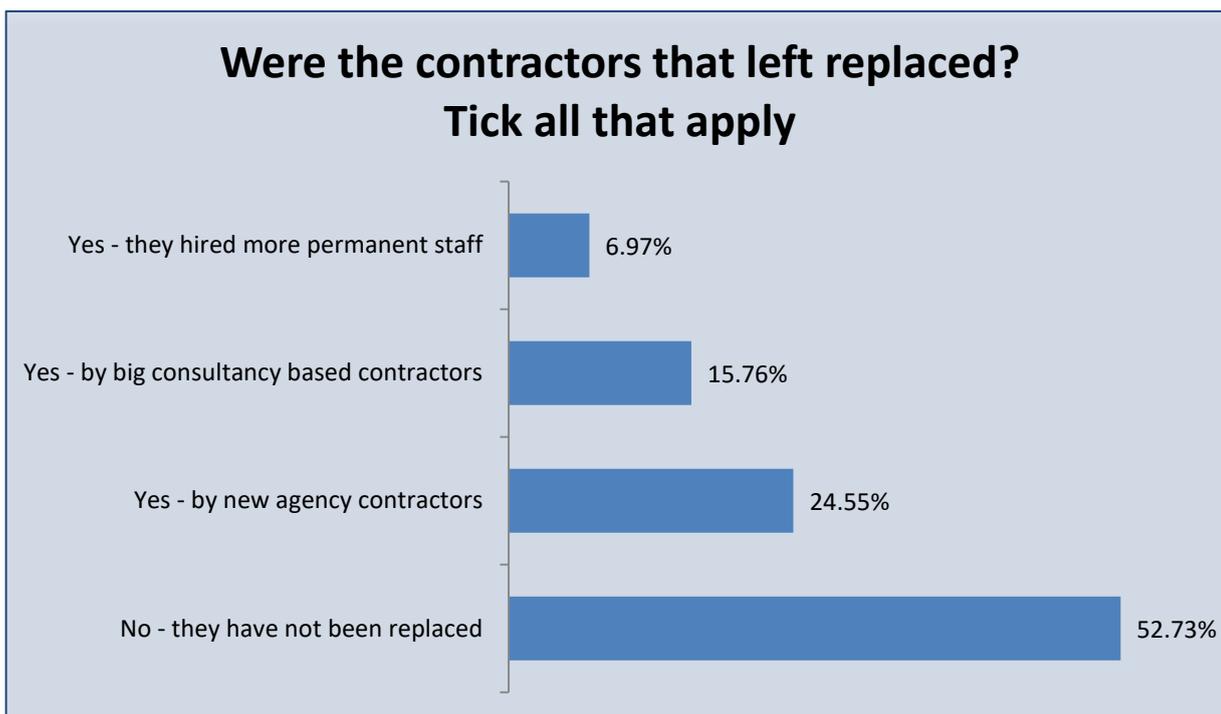
The vast majority of projects/departments in which contractors were working lost valuable skills and knowledge as a result of the reforms.

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52% of contractors could not be replaced, and big consultancies filled just 15% of the gaps

We asked contractors if they knew whether they had been replaced after leaving a client. 28% of contractors did not know what had happened after they had left. Those who did know revealed a worrying picture:

- Over half (52%) told us that the contractors who left had not been replaced
- A quarter of contractors were replaced by new agency workers
- Big consultancies managed to fill just 15% of the gaps [with higher charge rates]
- 7% were replaced by permanent staff



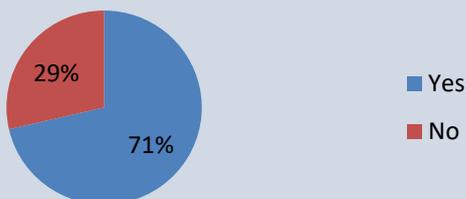
Half of the contractors who left the public-sector due to the IR35 reforms could not be replaced.

Seven in ten projects suffered delays because of contractors leaving

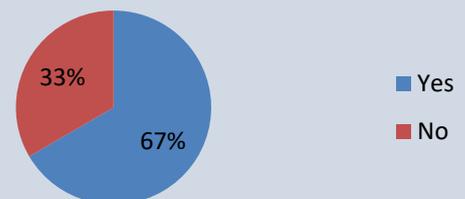
Respondents indicated that the projects they worked on were delayed as a result of the contractors leaving:

- 71% said that the projects they were working on were delayed
- 66% of the same contractors also said that they had heard of other public-sector projects suffering disruption because of the IR35 reforms
- Key sector breakdown for project delays: IT (79%), Interim management (74%), NHS/Health (65%)

Would you say the project(s) you worked on were delayed as a result of the contractors leaving?



Have you heard directly of other public sector projects within your sector that have been damaged by the IR35...

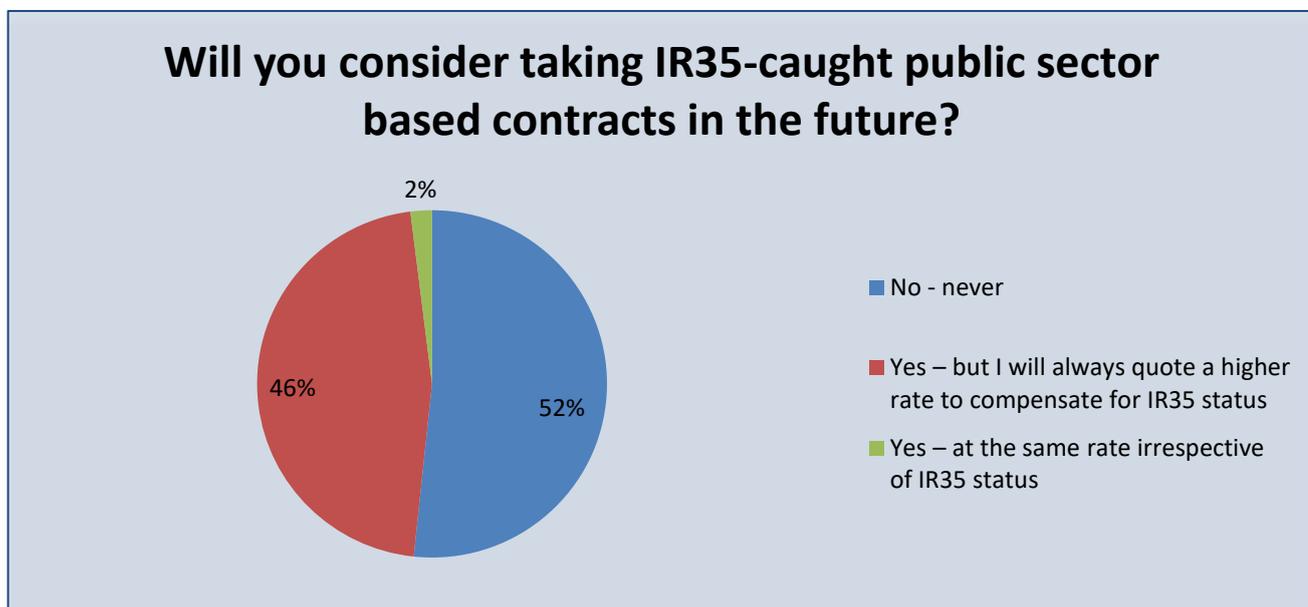


In the vast majority of cases, projects were negatively affected by the departure of contractors prompted by the IR35 reforms.

Over half of contractors will NEVER work in the public sector if caught by IR35. And 46% will only do so if the Government effectively pays the extra tax.

1,314 contractors responded to the question asking whether they would consider working in the public sector again if the contract was caught inside IR35.

- Over half (52%) said they would never work in the public sector, regardless
- 46% said they would, but only with a rate increase to compensate the extra tax – effectively meaning the public sector would pick up the cost of the extra tax
- Only 2% of contractors said they would work in the public sector on the same rate if they were caught by IR35

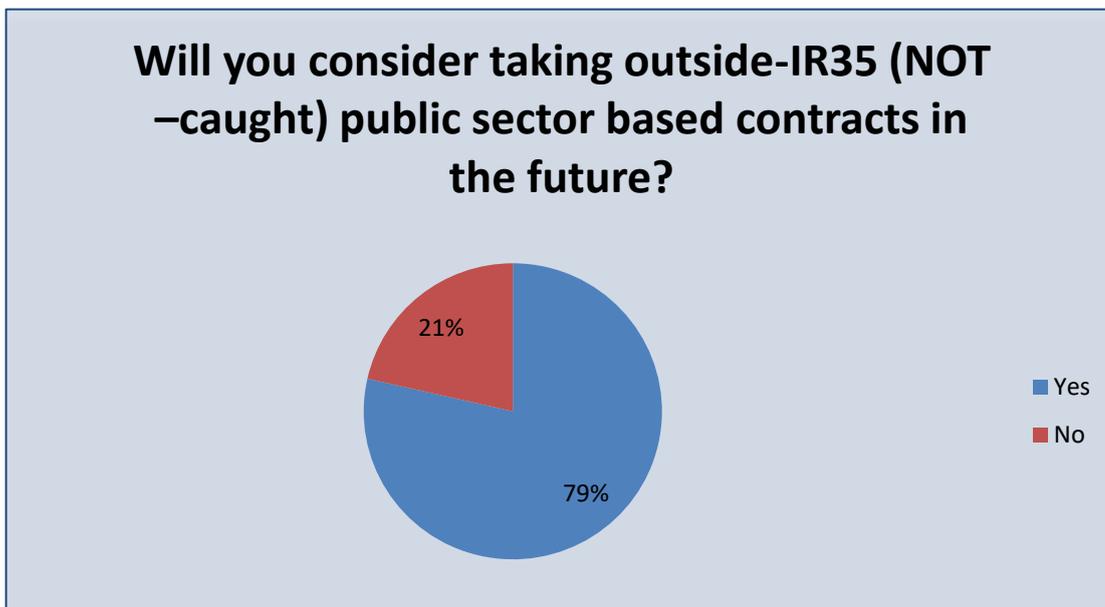


98% of contractors will not work in the public sector unless they can either work outside IR35, or if the Government pays the extra tax.

A fifth of contractors have now ruled out the public sector entirely as a place to work

With the additional red tape burden of the IR35 reforms in the public sector, we asked respondents if they would consider taking on public sector contracts, even if they were outside (not caught by) IR35:

- 21% of contractors said they would not work in the public sector even if outside IR35
- 79% said they would work if outside IR35

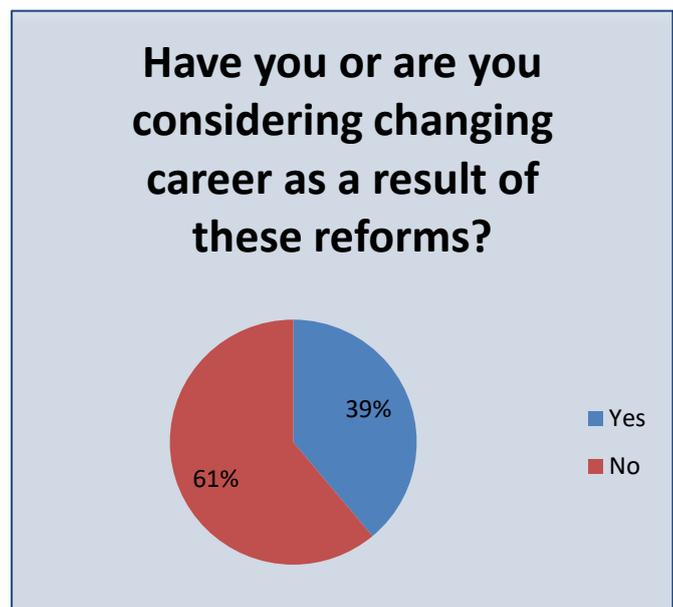
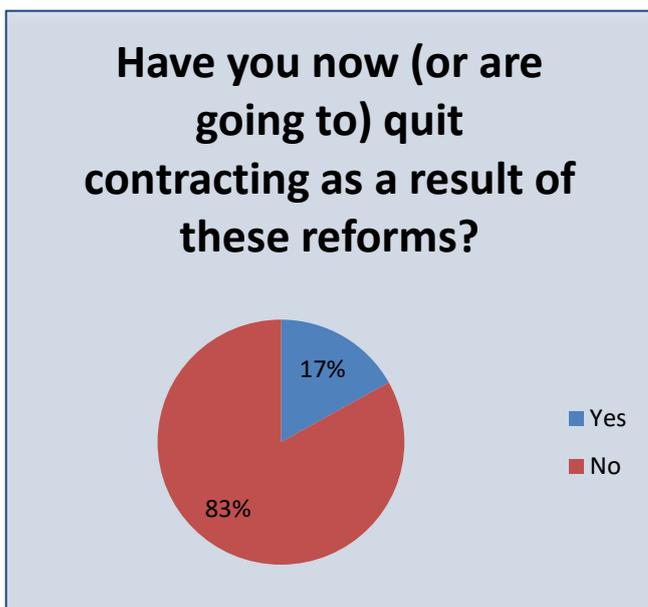


The extra red tape burden alone has proven enough to deter a fifth of the flexible workforce from contracting in the public sector in future.

The flexible workforce in the NHS / Health could reduce by 40% in the public-sector due to the reforms

We asked contractors if they would consider quitting contracting in the public sector because of the reforms:

- Overall, 17% of contractor across all sectors said they would quit contracting
- Key sector breakdowns of those considering quitting contracting:
 - 7% - IT; 11% - Interim management; **40% - NHS / Health**
- Breakdown for those considering changing career:
 - 40% - IT; 41% - Interim management; **63% - NHS / Health**



The NHS / Health may struggle to keep hold of its flexible workers following the reforms, with 40% contemplating quitting, and 63% considering changing career.

Qualitative data

In the survey we asked respondents to share their experiences, and describe how their projects had been affected by the reforms. The main themes expressed were:

- Chaos, confusion and lack of understanding amongst public sector organisations
- Criticism of HMRC for not offering enough support to public sector organisations and agencies
- Projects suffering due to delays and cancellations, costing millions of pounds
- A public-sector brain drain, with organisations struggling to replace critical contractor skills
- A crippling impact on the NHS/Health sector - services and staff morale suffering due to the changes

Respondents revealed that confusion over the reforms often led to non-compliance with the legislation from clients, causing many contractors to abandon projects.

- *“This has caused chaos. Some public sector organisations are applying deductions indiscriminately across the board, without being interested in an individual's IR35 status.”*
- *“The only constant is that the public body labels every engagement as inside IR35. Only once have I seen an application that the IR35 status will be evaluated on engagement.”*
- *“Public sector took an extreme risk averse stance. Their lack of knowledge of how tax rules apply to contractors inhibited their ability to make an accurate assessment of IR35 status.”*
- *“The organisation I was working with left things until the last minute, which resulted in a substantial number of contractors leaving.”*

Many contractors criticised HMRC for offering little in the way of support to public sector organisations and agencies during the implementation of the changes.

- *“HMRC's approach and communications were appalling. My agency did its best to keep contractors updated but they were generally left in the dark by HMRC until the final month.”*
- *“It's quite apparent HMRC and the government have no interest in supporting small businesses.”*
- *“Civil servants are completely confused as to how to assess the IR35 status of anybody they may hire. They have received no useful support from HMRC.”*
- *“The legislation is opaque. The tools HMRC have proposed are very poor and not fit for purpose.”*

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The disruption has cost public sector projects several million pounds, because of delays and cancellations.

- *“Lack of staff caused hiatus in time critical project which has led to its delay with a consequent cost overrun of circa £3m.”*
- *“Important enhancements to the projects we released to production were put on indefinite hold. Our three projects generated the government about £10m in just over a year, and these enhancements would have added more income.”*
- *“Huge delays within government department due to all knowledge disappearing overnight.”*
- *“Four entire projects I have been put forward for by recruiters have been cancelled due to confusion relating to IR35.”*

Contractors have been leaving the public sector in their droves. In the instances where public sector organisations have managed to replace contractors, it has often been at a greater cost.

- *“I now regard all public-sector engagements as high risk, and am considering abandoning the sector altogether. If they want employees they should hire permanent staff, not interim staff.”*
- *“HMRC lost almost all of their IT contractors in the London site. A lot of the work has now been picked up by blue chip consultancies, at greater cost to government.”*
- *“The IR35 reforms made it commercially uncompetitive to take public sector contracts. It's too complex for the recruiter to understand, so they prefer not to risk - even if it means losing their preferred candidate.”*
- *“I took earlier than intended retirement.”*

The NHS/health sector is feeling the strain imposed by the reforms. The departure of - and inability to attract – locum staff has had a devastating effect on services.

- *“The reduced number of locum doctors has increased the numbers of unfilled slots on rotas, meaning longer delays for patients to be seen and unsafe staffing on wards.”*
- *“I work in the operating theatre and lists have been cancelled due to lack of staff.”*
- *“Due to the latest legislation more doctors are frustrated, and talk more often about leaving the NHS.”*
- *“People with serious Mental Health problems are being left without support.”*

Survey demographics

- We received responses from 1522 contractors and 93 permanent staff.
- 90% of the contractors had been contracting for over a year, and 49.5% had been contracting over 5 years
- Sector breakdown: IT (33%); NHS/Health (13%); Interim or project management (12%); Engineering (9%), Finance (6%); with the rest in Other. Contract rates ranged from £100 to £2500 per day.
- 93% of contractors traded via a limited company. The rest were either payroll/umbrella or sole trader.
- 47% of contractor respondents were working for a public-sector body prior to or shortly after April 2017. Our survey data set is “from the knowledgeable coal face”.
- 97% were aware of the new IR35 rules. 93% at least fairly familiar with IR35. 38% very familiar.
- Survey was conducted during July 2017.

IR35 Reforms in the news

Experts slam logic underlying the HMRC IR35 tool [05/June/2017]

http://www.contractorcalculator.co.uk/experts_slam_logic_underlying_hmrc_ir35_tool_535010_news.aspx

NHS locum doctors avoid IR35 by being lured to the private sector [18/May/2017]

http://www.contractorcalculator.co.uk/nhs_locum_doctors_avoid_ir35_private_sector_534610_news.aspx

Is HMRC facilitating tax avoidance with its own IR35 status tool? [06/Apr/2017]

http://www.contractorcalculator.co.uk/hmrc_facilitating_tax_avoidance_ir35_status_tool_534310_news.aspx

HMRC ESS tool has no legal authority, says IR35 legal expert [21/Mar/2017]

http://www.contractorcalculator.co.uk/hmrc_ess_tool_has_legal_authority_ir35_533910_news.aspx

Public sector IR35 reforms are ‘a departure from reality’, warn experts [08/Dec/2016]

http://www.contractorcalculator.co.uk/public_sector_ir35_reforms_experts_531410_news.aspx

New IR35 rules using RTI are a ‘nightmare’, warns tax expert [10/Aug/2016]

http://www.contractorcalculator.co.uk/ir35_rules_rti_nightmare_warns_tax_expert_529210_news.aspx

IR35 reforms will decimate Government projects, survey shows [03/Aug/2016]

http://www.contractorcalculator.co.uk/ir35_reforms_decimate_government_projects_528910_news.aspx

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