

The BIG IR35 Survey: 12,327 Contractors

Rife non-compliance killing flexible workforce

Introduction and Background

In the largest survey of contractors to date concerning IR35 and Off-Payroll, we compiled the views of more than 12,000 contractors, to understand their experiences of the Off-Payroll legislation in the build-up to its private sector implementation. The survey gauges the various approaches hiring clients and agencies have taken in response to their compliance requirements, contractor sentiment and planned courses of action in response to such measures.

The Intermediaries Legislation, better known as IR35, was enacted in April 2000 and sought to identify 'deemed employees'. These are limited company contractors whose working relationship with their client would be considered one of employment if the contractor didn't work via their limited company. An engagement of employment is subject to higher direct taxes, due largely to the fact that employer's National Insurance Contributions (NICs) aren't due on contract income. IR35 therefore sought to ensure that HMRC's tax yield from engagements involving 'deemed employees' produced a similar tax yield to engagements of employment. This involved contractors assessing their IR35 status before declaring their position to HMRC and paying the appropriate tax.

The Off-Payroll legislation was introduced to the public sector in April 2017. Billed by Government as 'reform' of IR35, the legislation introduced changes to compliance requirements and the tax treatment of affected engagements. The administrative and compliance burden, employment tax liabilities, and a significant degree of tax risk, were now borne by end-clients and agencies, with little in the way of support from HMRC to manage their new responsibilities.

Consequently, much independent research into the public sector implementation of the Off-Payroll legislation suggests that it was plagued by efforts by clients and agencies to circumvent their responsibilities and financial risk. Many organisations reportedly adopted 'blanket' approaches to assessing status, refusing to engage legitimately self-employed contractors on an 'outside IR35' basis, while sourcing their employment tax liabilities unlawfully from the contract rate. As the private sector implementation of the Off-Payroll legislation draws near, we are hearing countless reports of the same trend emerging. As well as helping to expose the extent of non-compliance with the legislation, this survey attempts to forecast the projected fallout and the wider repercussions for contractors, UK Plc and HMRC.

Executive Summary

The build-up to the extension of the Off-Payroll legislation to the private sector has been plagued by non-compliance. Clients and agencies are seeking measures to mitigate perceivably burdensome compliance requirements and the tax risk suddenly accompanying the engagement of a limited company contractor. Blanket bans on the engagement of limited companies are rife across the sector, forcing many genuinely self-employed contractors into 'false-employment'. Many clients seeking to protect their budgets and costs are also sourcing employment costs out of the contract rate advertised to contractors, perhaps not realising that this strategy is unlawful.

The fallout has manifested in the breakdown of contract engagements and a migration of contracting talent away from the sector, impacting on client projects and intensifying recruitment challenges. There's also the threat of further repercussions for firms that continue to adopt the non-compliant approach to Off-Payroll. Many contractors have indicated that they would be prepared to mount a challenge for the employment rights many feel should justifiably accompany the status of 'employed for tax purposes'.

Key points and observations:

- This is the largest survey to date of the flexible workforce concerning IR35.
- Contractors are out of work and have abandoned clients for fear of retrospective action from HMRC.
- Firms are ill-prepared, poorly educated, and often acting non-compliantly with the legislation.
- Assessment processes are frequently non-compliant and unfair.
- Lawsuits are inevitable due to the unlawful deduction of employment taxes from contract rates.
- Employment tribunals are highly likely as contractors seek to claim rights to accompany their tax status.
- Overwhelming mistrust and rejection of CEST has compounded status disputes.
- Firms suffer both short and long-term damage as contractors leave.
- The mobility of contractors has been decimated overnight, due to inability to claim travel expenses.

It's clear that the Off-Payroll legislation is not fit-for-purpose. The complex employment status test at the centre of the legislation and the punitive measures applied to those responsible for applying the legislation are wreaking havoc. The majority of contractors advocate an alternative solution: an effective 'contractor levy', payable by end-clients on the services provided by contractors, regardless of IR35 status.

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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 300,000 contractors each month. He is also author of two books – 'The Contractors' Handbook', and 'IR35 & Off-Payroll explained' (publishing in March 2020).



In April 2000, when the original IR35 (ITEPA, chapter 8) came into force agencies and clients had to facilitate hiring contractors on a genuine 'outside IR35' basis to attract talent. The difference with the Off-Payroll legislation (ITEPA, chapter 10) is that it is contrived in such a way that it disincentivises doing so.

Suddenly, firms are responsible for enforcing a legislation characterised by an unnecessarily complex employment status test, underpinned by case law that multiple recent tax tribunal outcomes have shown HMRC itself is yet to fully grasp. The complexity of the legislation, the uncertainty over status determinations and the lingering threat of HMRC's advances are all effective deterrents against engaging a contractor on an 'outside IR35' basis. A failure by HMRC to sufficiently prepare and educate clients and agencies has only compounded matters.

As we predicted two years ago, we have seen firms, motivated by board level decisions to reduce risk, adopt 'inside IR35' blanketing measures. Consequently, contractors have abandoned projects to avoid being subjected to unfair tax treatment and projects have inevitably suffered. We expect the cost to firms of engaging the best and brightest contracting talent will shoot up.

The private sector fallout wasn't difficult to predict, because much of this had already occurred in response to the April 2017 public sector 'test run'. Independent research revealed the widespread adoption of blanket approaches to Off-Payroll compliance and the resulting breakdown of engagements and damage to projects. Nonetheless, HMRC and Government deemed the legislation a success, stating that it had delivered an increase in compliance by virtue of the fact that more tax was retrieved via Pay As You Earn (PAYE). As a result, the taxman repeatedly denied and downplayed the evidence to the contrary.

The Off-Payroll legislation is a lose-lose situation for all involved. Many legitimately self-employed must choose between unfair tax treatment or diminished contract engagements, hiring firms suffer damage to projects and rising costs, and HMRC's tax yield inevitably suffers as a result of the lack of activity.

But the biggest losers are the more vulnerable workers at the bottom of the pile. These are the low paid self-employed for whom Government has explored measures to support through its Good Work Plan yet is simultaneously victimising through the Off-Payroll legislation. With minimal bargaining power, these individuals will have little choice but to accept engagements where they are deemed 'employed for tax

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purposes', taxed more and paid less, all without receiving the requisite rights that their status should warrant.

HMRC's Check Employment Status for Tax (CEST) tool is only muddying the waters further. Use of CEST by firms to assess the IR35 status of engagements is actively encouraged by HMRC. However, CEST doesn't enact the case law underpinning IR35, it merely applies the taxman's blinkered interpretation, and is consequently geared towards deeming engagements within scope of the rules. Worryingly, the tool omits key areas of law and is grossly inaccurate.

Meanwhile, HMRC has already demonstrated a tendency toward challenging the 'outside IR35' determinations issued by the tool, heaping unjust tax bills upon hiring organisations simply carrying out their compliance responsibilities in line with the taxman's instructions. The outcome of HMRC's abuse of this regime is fear within the market, further stoking the non-compliance that the taxman has so far shown no interest in addressing.

History is about to repeat itself, only the repercussions will be felt on a far greater scale. Whereas HMRC may once more point towards an uptick in payroll taxation as evidence of Off-Payroll's supposed success, the diminished company tax yield and long-term damage to the economy won't be felt so immediately. The concern is that it may take HMRC some years to realise the gravity of this mistake.

If Government wants an easy way of raising some tax, it can scrap IR35 and Off-Payroll and simply introduce a hirers tax. Whilst many contractors who completed this survey supports this proposal, politicians won't vote for it and HMRC isn't in the habit of acknowledging its failures. Nonetheless, we hope that this survey can not only inform the market, but guide HMRC and Government towards a more well-rounded view on proposals that threaten to destroy the UK's flexible workforce.

Summary of all findings

Contract rates contradict HMRC rhetoric

The 'freelancer premium' – the added taxable income supplementing a contract rate to compensate for the risk of contingent work – has long contradicted HMRC's narrative concerning tax gathered from the self-employed and is reinforced here.

- Two thirds (66%) say they get paid more than their permanent counterparts, generating more tax, undermining Government's claims of regarding supposed tax avoidance. [Q8]
- 82% of contractors are currently in contract, with 18% out of work. [Q9]

Off-Payroll legislation forces contractors to abandon projects

The Off-Payroll legislation has encouraged many contractors to abandon projects. Struggles to secure 'outside IR35' contracts with clients and agencies unwilling to expose themselves to tax risk and a perceivably high compliance burden has left many contractors out of work.

- Three quarters (75%) of the contractors out of work say the reason is IR35 [Q10], while 74% claim it's unusual to be out of work for this long. [Q16]
- Of the contractors out of work, half (50%) claim they left their last client due to IR35. [Q14]

Contractor/client showdown compounds recruitment struggles

The refusal by end-clients and agencies to abide by their compliance responsibilities has resulted in a showdown with contractors, forcing many to down tools for prolonged periods of time, feeding into the recruitment struggles detailed elsewhere in this study.

- 42% of contractors say their last client banned PSC contractors, while only 13% say their last client was carrying out compliant assessments on an individual basis. [Q11]
- 32% of out of work contractors have been so for more than three months. [Q15]

Poor Off-Payroll preparation causes market disruption

Insufficient support from HMRC and unrealistic compliance requirements are likely to blame for less than a third of firms taking the necessary preparatory measures, while concerns over historical IR35 risk cause contractors to leave clients, disrupting the market.

- 37% of contractors have not yet been assessed for IR35 and are still awaiting their fate. [Q18]
- 12% terminated their last contract to work with their current client because their previous client wouldn't hire them on an 'outside IR35' basis. [Q19]
- Only 31% of respondents claim their client is conducting case-by-case status assessments, contrary to Treasury claims. [Q21]

Unlawful assessments driving contractors into false-employment

Contractors report that the majority of status assessments they are subject to aren't in line with Off-Payroll requirements and are likely unlawful, resulting in a disproportionate amount of 'inside IR35' assessments with a distinct lack of transparency.

- 53% of respondents say their client has assessed their IR35 status using CEST, despite it's known flaws. [Q23]
- 69% of respondents believe the assessment process applied to them was unfair. [Q25]
- 58% do not believe their client adhered to the Off-Payroll legislation's 'reasonable care' requirement when assessing their status. [Q26]
- 68% of contractors were not even involved in assessment process. [Q27]
- Only 27% of contractors have received an 'outside IR35' status determination, contrary to HMRC claims that roughly two thirds should be outside. Meanwhile, half (50%) received an 'inside IR35' determination. [Q28]
- Only 38% of respondents have been provided with a Status Determination Statement (SDS), despite it being a legal requirement under the legislation. [Q29]
- 62% say their client has not provided reasons for their status determination, despite being a requirement of an SDS. [Q30]
- Only 1% of respondents successfully disputed their IR35 status, resulting in a change. [Q31]

Firms use blanket limited company bans the circumvent compliance

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Efforts by clients to circumvent their compliance requirements while negating their Off-Payroll tax risk has resulted in contractors being offered various operating models, all of which subject them to employment taxes regardless of their IR35 status.

- 30% of contractors have been offered umbrella company contracting as an alternative operating model. [Q34]
- 14% have been offered either a permanent or fixed-term employment contract. [Q34]
- 13% have been offered an agency PAYE arrangement. [Q34]
- 35% are still yet to be offered an alternative means of contracting. [Q34]

Firms subject contractors to unlawful double tax charge

Most contractors are suffering an effective double tax charge as clients and agencies unlawfully source employment taxes from the contract rate. It's uncertain whether this exploitation of affected contractors is a result of intentional misrepresentation of the facts or HMRC's failure to educate the sector.

- 78% of contractors haven't renegotiated their contract rate [Q36]
- 54% say that employer's NI is being unlawfully deducted from their contract rate. [Q37]
- 43% of respondents are aware that employer's NI cannot lawfully be deducted from their rate. [Q38]
- However, 45% have been told falsely that being found 'inside IR35' meant they are liable for employer's NI. [Q39]
- 14% of contractors have been told that their contract rate is an "assignment rate" from which employer's NI is deducted. [Q40]
- 89% of respondents will primarily seek to avoid contracts that are 'inside IR35'. [Q54]

Mistrust of HMRC and CEST driving status disputes

CEST's well-documented flaws and failure to align with case law mean most contractors don't trust its accuracy. There is also substantial mistrust of HMRC's pledge to stand by CEST's outcomes, following recent reports of the taxman challenging status determinations derived from the tool.

- 91% of respondents have heard of CEST. [Q42]
- Only 9% of contractors would accept a decision by CEST that IR35 applies. [Q43]
- 72% of contractors do not trust the accuracy of CEST, whereas only 3% say they trust it. [Q44]
- 70% of contractors agree that CEST doesn't reflect the law, while just 2% believe it does. [Q45]
- 79% of respondents do not trust HMRC to stand by results issued by CEST. [Q46]

Firms take mitigating measures to combat contractor exodus

Hiring firms are already feeling the impact of damaging Off-Payroll policy as contractors abandon projects in their droves. With recruiting challenges already apparent, many firms are already beginning to offshore work, damaging the public purse.

- 51% of contractors believe their clients have suffered at least a 50% leave rate of contractors due to IR35. [Q49]
- 41% say that their client has moved at least some offshore as a result, with 7% suggesting most work has moved offshore. [Q50]
- 41% of contractors believe their client's will suffer long-term damage as a result of IR35. [Q51]

Off-Payroll signals last straw for crucial contracting talent

Feedback indicates the damaging legislation is to drive a significant portion of the contingent workforce out of the market, with those who remain hampered by Off-Payroll imposed mobility issues that will disproportionately affect rural clients.

- 23% of contractors will not remain with their current client after April 2020. [Q20]
- 13% say they are very likely to leave the UK, while 25% say they are somewhat likely to do so. [Q53]
- 45% say they will no longer travel for work if deemed 'inside IR35', and 50% would only travel for work if their rate were increased accordingly. [Q57]
- 23% of respondents intend to quit contracting because of IR35. [Q58]
- 21% of contractors plan to change career. [Q59]

- 13% plan to retire as a result of IR35. [Q60]

Measures needed to counter Off-Payroll ‘zero-rights employment’

The majority of contractors advocate the provision of the requisite employment rights for contingent workers deemed ‘employed for tax purposes’ by clients, as a means of restoring some degree of parity while providing a deterrent for firms applying blanket assessments.

- 92% of contractors want sick pay if deemed ‘inside IR35’, while 75% want maternity/paternity leave, 82% want legal protection for disciplinary and grievance issues, and 81% want access to income support. [Q55]
- 58% of respondents say they would lodge an appeal at an Employment Tribunal to secure employment rights from their client, if found ‘inside IR35’. [Q56]

What’s the solution?

Posed with an alternate solution that could secure HMRC the same anticipated tax yield without threatening burdensome compliance requirements and non-compliance at the expense of contractors, the majority of respondents unsurprisingly approved.

- 79% of contractors agree that a simple levy on the engagement of contractors, payable on top of all contract rates by clients, would be a better alternative to IR35 and the Off-Payroll legislation. [Q61]
- 31% believe 5% would be a reasonable rate. [Q61]

Survey demographics

- We received responses from 12,327 contractors.
- 94% of the contractors had been contracting for over a year, and 61% had been contracting over five years.
- Sector breakdown: IT (43%); Interim or project management (3%); Engineering (12%); Finance (12%); with the rest categorised as 'Other'. Contract rates ranged from £100 to £2500 per day.
- All contractors usually trade via a limited company.
- The survey was conducted between 1st and 2nd March 2020.

About ContractorCalculator

20 years of serving the UK's contracting community



ContractorCalculator is the UK's leading contractor brand and website for contingent workers, with circa 300,000 visitors per month. A vital resource hub, offering a range of free online financial and tax calculators, as well as expert commentary from industry leaders. We also publish the contracting industry Bible, the Contractors' Handbook.

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END OF REPORT

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