

## IR35 & Off-payroll – what does the future hold for contractors?



Will contracting survive, we ask ourselves? My response is a firm yes. Contracting will survive, but in a different form, as the market recalibrates after the Off-payroll reforms entered the private sector in April 2021. Give it one to two years, and genuine contractors will be back operating as usual. Here I share my views about what happened and what the future might hold.

### Off-payroll post-mortem

After the [Stop The Off-payroll Tax Campaign](#) failed to get the vote in Parliament in July 2020, the market needed to start preparing for the most significant upheaval in the contracting sector since the original IR35 legislation in April 2000.

As April 2021 approached, the belief that further delays may ensue encouraged some firms to sit on their hands. But unfortunately, Off-payroll had already entered primary legislation and was therefore inevitable.

Consequently, we saw large numbers of firms finally deciding at the last minute to try and deal with the thing they had been putting off for a very long time – implementing an IR35 assessment regime. Unfortunately, it was too late to do so. For many firms, the sensible option was to press the reset button and temporarily ban the use of contractors operating via limited companies.

And who could blame them? The pandemic was still very much alive and pressuring firms' survival. Demand for contractors was low due to many already being benched. Firms could leverage the skewed supply/demand curve to access the talent they need.

And all that was against the backdrop of the "IR35 PR wars", which saw firms with vested interests try and scare the living daylight out of hirers if they so much as dreamed of hiring a contractor using a limited company.

More competent firms who took more considered approaches gained an advantage over those who cowed to the pressure, and now they are struggling to attract the contractors they need.

### Market changes

It's worth noting that the original plans for Off-payroll were a wholesale replacement of the unworkable rules that had existed since April 2000. Even HMRC have admitted that it was largely unenforceable. They are right, but, ironically, as someone who co-defends IR35 cases at the tribunal, I can tell you that HMRC is going to have a much harder time when it comes to enforcing its replacement.

Those with tribunal experience know the three most important words needed to protect clients: Evidence, evidence, and evidence. The need to discharge the burden of proof at the tribunal and shore up a defence is why we innovated and launched [Monitoring at IR35 Shield](#) a long time ago.

Why is evidence so important when heading to a tribunal, one might ask? Simply because judges are not very easy to convince if you don't have any. HMRC have extraordinary powers and can form an opinion that tax is owed, leaving the onus on the taxpayer to discharge their burden of proof. To do that requires evidence – and hearsay (or "gossip") is unlikely to be enough.

## Soft landings & unreasonable fear-mongering?

Not content with some of the fear-mongering nonsense spouted by pop-up IR35 experts during the "IR35 PR wars" pre-April 2021, the gangs appear to have reformed their act. They are now attempting to leverage the "soft landing has ended mantra" by tying it in with questionable arguments about reasonable care.

I first wrote about these misguided fear-mongers back in October 2021 in a [piece on IR35 Shield](#). There are two trigger points for reasonable care. One is in the Off-payroll legislation related to conclusions in Status Determination Statements, and the other is the lack of reasonable care ("carelessness") in the Taxes Management Act 1970. Conflating the two to flog billable hours when firms are probably doing ok is dishonest.

Whether someone has been careless or not exercised reasonable care is asking whether someone has been negligent. And to answer that, you need to understand who the person is, what they know, what is in their mind at the time, and whether they did or didn't perhaps do what they should have known to have done. [HMRC guidance on penalties](#) explains how the penalties are a percentage between 0 and 30% on top of the extra tax due. Only if errors have been deliberate and concealed do they hit 100% - which isn't a reasonable care issue. HMRC have also never won a carelessness argument on an IR35 matter in tax tribunal for the 22 years since the legislation began. The burden of proof is on HMRC, and given the subjective nature of IR35, it isn't easy to see how they ever will.

If HMRC turns up four years after tax returns have been submitted and ask the right questions to ascertain whether a firm (or person) has been careless or not, guess what you might need to have to show that you haven't been? Yep, that's right. It is evidence again. And, more importantly, of the right kind.

The topic of reasonable care is not straightforward. Neither is Off-payroll. And neither is understanding the rules of evidence. And this is why expertise by professionals with proven tribunal experience commands a premium.

## The tax Offsets issue

There has been one major flaw in the Off-payroll legislation that has been exposed by the Government's National Audit Office (NAO). The issue was then confirmed by the Head of HMRC at the Public Accounts Committee on 21st February 2022.

Despite multiple representations being made to HMRC for almost two years, they did not seek to put into law a statutory instrument to cater for tax offsets when unwinding an "outside IR35" position if HMRC successfully overturned the status decision.

We all surprisingly discovered that the client pays the full amount of tax, and the contractor gets a refund for any corporation tax and income tax on dividends they have already paid. These facts, [reported in the Financial Times](#), have dumbfounded tax experts.

This finding has consequences in the IR35 insurance industry because it means any insurance policy bought by a contractor which purports to protect other parties in the supply chain does not work. They don't work because there is no "insurable interest."

[According to the Association of British Insurers](#), insurance law means "you can only buy insurance for something or someone in which you have an insurable interest." Contractors who believe they have been mis-sold can [complain to the Financial Ombudsman Service](#).

Contractors should also take heed of the Managed Service Companies legislation, which has also [reared its ugly head again](#). As IR35 Shield [explained over a year ago](#), agencies touting tax loss insurance might be creating risk for the contractor and themselves.

## And the umbrellas?

As the cliché goes, "Sunlight is the best form of disinfectant", and there's been an awful lot of muck that has surfaced in this industry over the past year or so. The rackets on withholding holiday pay and other skimming scams were exposed. I think this is because vast numbers of tax-savvy contractors have, for the first time, been questioning why their pay packets weren't what they expected.

As we move forward, there's no way these scams can continue any longer, and an umbrella that has a business model around retaining any monies other than the margin they charge may need to recalibrate.

We are now seeing third-party real-time auditing services for umbrellas that ensure every penny ends up where it is supposed to go. These are likely to define the future and be an essential part of the due diligence for umbrellas, with hirers dictating their umbrella PSLs rather than the recruitment agencies.

HMRC will be responding to the [Call for Evidence on umbrellas](#) in due course. Regulation seems inevitable, and it will require automation. Because at the moment, HMRC appears to be at least a year behind closing down schemes that are alerted to them - by which time the operators have made their money and fled, leaving the taxpayers holding unexpected bills. That cannot continue.

## The positive IR35 future

So, how is the market going to shape out?

Many firms are finally getting around to engaging with the new legislation, primarily because they cannot get access to the people they need if they don't. Commercial drivers dictate that some contractors won't even entertain "Inside IR35", however much you pay them.

As firms recover from the pandemic and gain more confidence to invest, they need access to talented contractors.

Many freelancers have thrown in the contracting towel for many reasons, not all of which are IR35 related. Some just decided to retire or take jobs more locally, rather than stay on the contracting hamster wheel, which requires always looking for the next piece of work.

Resilient contractors who haven't quit are still very active and resourceful. There's a huge market opening up for opportunities for which the new legislation doesn't apply. Activity includes the creation of small niche consultancies and working remotely for overseas clients – because, in both scenarios, the new rules do not apply.

Firms are also shunning the hire of UK-based contractors and using remote workers, again, because the new rules don't apply. The golden rule here is to not work for a firm in your own country - one of the behavioural consequences of poor legislation.

Personally, my money is on the rise of the small consultancies in the UK. I think they will begin to outshine recruiters and steal a considerable market share. We are already seeing some recruiters trying to set up consultancy arms. HMRC are alive to this already, and their compliance checks ask questions about "fully contracted-out" service providers.

As the dust settles, HMRC will get what they wanted (more money via PAYE), and the contracting market will survive.

*[This is a blog piece by Dave Chaplin, CEO of ContractorCalculator, and founder of [IR35 Shield](#).]*

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