

## Off-payroll (IR35) – How to effectively hire using contracted-out services



Since the inception of the Off-payroll legislation in April 2017 billed as a reform to IR35, there has been a proliferation of consultancies offering services to clients. But, all parties in the supply-chain should be careful to ensure that the consultancy really is a fully contracted outside service, otherwise they may find themselves subject to considerable future tax bills, so says Martyn Valentine, founder of [The Law Place](#), who has been providing legal advice and guidance on IR35 matters for over a decade.

“HM Revenue & Customs has published [guidance in ESM 10010](#) giving rise to more questions than answers,” says Valentine who explains that the legal position remains unchanged. “In the guidance, HMRC outlines the law (section 61N(1)(a) Income Tax (Earnings and Pensions) Act 2003) which refers to the client as “the highest person in the chain” for whom the worker provides their services but fails to provide much needed clarity.”

This issue continues to cause confusion and concern because a customer seeking to procure IT services, for instance, may rely on potentially false representations from a consultancy that there's no need to undertake status determination statements in respect of the Off-payroll legislation because the consultancy claims it is the client, not the customer. There is nothing in the Off-payroll legislation to protect them if they get this decision wrong – making them potentially liable for any future tax bills if HMRC disagrees and issues notices of determination that the engagements are caught within IR35.

On the flip side, if they are right, and a consultancy is genuinely providing a wholly outsourced service to its customer, then the consultancy is the client for the purposes of Off-payroll.

### Beware of body shops masquerading as consultancies

Some consultancies have sought to offer their customers a tax-efficient service by relying on the small companies exemption to entirely bypass the obligation to undertake status determinations and risk of taxes.

However, HMRC can challenge the bona fides of such an arrangement with potentially ruinous consequences for both the consultancy and its customer. Valentine explains that that “HMRC will examine the core question of the customer's capacity; is the customer procuring a wholly outsourced service from the consultancy or simply hiring workers?”

This is the same question at the heart of the original IR35 legislation. The inquiry process will involve an examination of the contracts, but, as Valentine explains “HM Revenue & Customs cannot “do violence” to the contracts in the same manner as an IR35 inquiry and override a legally binding contract. Demonstrating that a contract is a sham is evidentially challenging but not impossible.”

If the outcome of the inquiry is that the consultancy is not the client of the contractor, the customer will be deemed to be the client for the purposes of Off-payroll if its true capacity is simply a hirer of an individual worker. The consultancy will by default be the “fee-payer”, liable for any underpayment of taxes, but if no status determination statements were given to them, their customer will become fully liable instead.

## What are the pitfalls to avoid?

Valentine warns of poorly drafted contracts. "We have seen many poorly drafted contracts which are nothing more than vanilla recruitment contracts where the word 'agency' has been replaced by 'consultancy'. A consultancy agreement is radically different to a repurposed recruitment contract and will define the consultancy's obligation as the provision of an agreed service consisting of identifiable and measurable outputs. Suffice to say, the process of recruitment is entirely different to the provision of an outsourced service."

Another misguided approach is what Valentine refers to as a "Disguised agency". This is where the consultancy's obligation is to recruit an individual to fill a role instead of providing a wholly outsourced service. Valentine says that "A consultancy risks being liable for breach of the [Conduct of Employment Agencies and Employment Businesses Regulations 2003](#) if its true obligation is to provide individual workers."

Badly drafted Statements of Work are also prevalent says Valentine, who explains the issues he has seen: "The term 'statement of work' has been bandied about like [snake oil](#) or an 'amazing discovery' on a late-night infomercial for years. Merely adding a few bullet points to the services description instead of a job title provides no protection for the consultancy or customer. More often than not, statements of work are nothing more than job descriptions with the inherent risk of the customer being deemed to be the client. If the statement of work resembles a requirement for an individual rather than a service, then the work is not a contracted-out service."

Bizarrely, Valentine has even seen instances where there are no contracts at all. "HMRC has powers to examine all the contractual documents in a transaction. A contract between a consultancy and a contractor may point way from being within IR35 and set out specific deliverables, but the consultancy may have neglected to supply an equivalent contract to its customer." The correct way, as Valentine explains is for the consultancy to have in place a robust contract with each contractor and a mirroring contract with each customer. Sometimes customers insist on the use of their own terms. In this case, a consultancy should seek independent legal advice concerning risks involved.

## What are best practices for engaging consultancies under Off-payroll?

Valentine sets out a five-point plan for consultancies to follow and re-assure their customers:

**Step 1 - Confirmation letter if small:** If applicable, certify to its customers that it is small and provide confirmation that a "section 60H" client-size confirmation letter has been issued to any and all contractors using companies.

**Step 2 – use assessments or assurance:** Provide status determination statements or tax assurance letters to customers. While a small client is outside the scope of Off-payroll, a consultancy's customer will be reassured to receive a status determination statement or tax assurance letter in respect of each contractor using a limited company. The key point is that a status determination statement or tax assurance letter will provide evidence that reasonable care has been taken.

**Step 3 – Use warranties:** A consultancy can insert a warranty in the contract with its customer to confirm that all contractors using companies will obtain legal advice on the status of an engagement. Legal advice can only be credible if the adviser is sufficiently competent and experienced to advise.

**Step 4 – Ignore CEST:** Don't rely on CEST, which is flawed and which does not take into account the nature of the services to be provided and, cannot provide guidance on whether a service is wholly outsourced. Substitution can be disregarded if the customer's requirement is for a specific individual and not a specific service. CEST is not legally binding and HMRC will ignore it.

**Step 5 – Seek advice:** Seek competent and impartial legal advice - a specialist lawyer insured to provide employment status advice can draft a package of contracts for use by a consultancy and provide ongoing support to ensure that the work reflects a wholly outsourced service.

*Martyn Valentine is founder and Director of [The Law Place](#), which has been providing advice and guidance on IR35 and Off-payroll matters for more than 15 years. He currently assists a wealth of end clients and contractors to help ensure their contracts are legally water-tight and fair to all parties.*

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