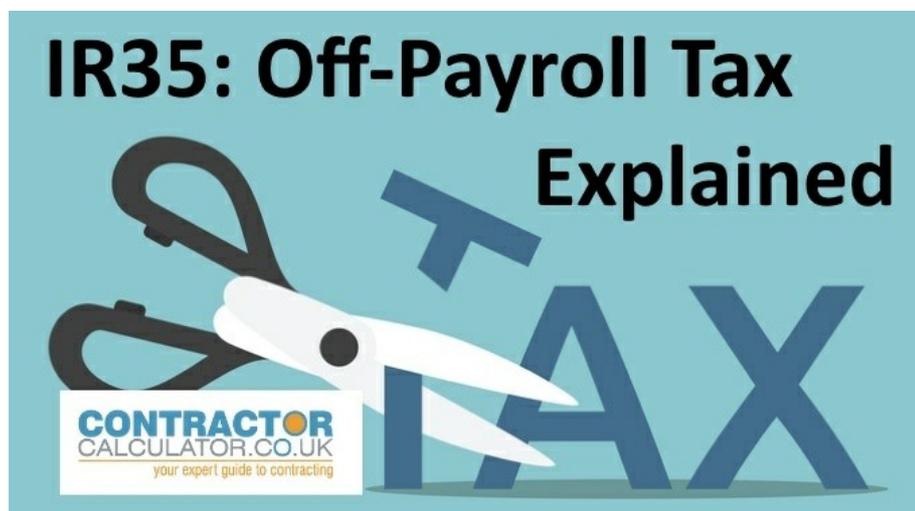


What is the new Off-Payroll (IR35) tax?



From April 2020, the new Off-Payroll tax rules will also apply in the private sector and be used to determine the [IR35](#) status – or ‘deemed employment’ status - of limited company contractors in the majority of engagements. What was once solely an issue for contractors to navigate now imposes new compliance requirements and tax liabilities on clients and agencies.

With newfound skin in the game for all parties within the contractor supply chain, a comprehensive understanding of the new Off-Payroll tax and IR35 are essential requirements for everyone involved to meet their compliance requirements, mitigate their risk and maintain their competitiveness.

What are IR35 and 'Off-Payroll'?

IR35 is tax legislation intended to combat tax avoidance by companies that hire limited company contractors. It is now a phrase that loosely covers both the original Intermediaries Legislation (Chapter 8 of ITEPA), introduced in April 2000, and the more recent Off-Payroll tax rules (Chapter 10 of ITEPA), introduced in April 2017.

IR35 applies to contractors who would otherwise be considered an employee of their client according to employment law, were it not for their limited company. HMRC refers to these individuals as ‘deemed employees’.

Whilst limited company contractors receive modest tax advantages when compared with permanent employees, firms circumvent the need to pay employment taxes when they hire contractors, which HMRC contests has resulted in much tax-motivated incorporation. In 2000, the taxman introduced IR35 to distinguish between genuine contractors and deemed employees.

IR35 has traditionally required that limited company contractors [interpret a complex set of employment status tests](#) to determine whether their contract places them inside (‘IR35 applies’) or outside (‘IR35 does not apply’) of the legislation’s scope.

Being deemed within scope of IR35 in its original iteration requires that a contractor deduct both employer’s and employee’s NICs from earnings attributed to the contract in question. This double taxation results in a substantial reduction in take-home pay, roughly in the region of 20%, and means that contractors pay significantly higher tax rates than employees, because they are required to pick up the hirer’s tax bill too. But, this changes under the new rules, as explained later.

The tests of employment: How is IR35 status determined?

Determining IR35 status involves considering a particular engagement in relation to a number of tests of employment established in case law. The three key tests of employment deemed most important are:

- **Personal service/substitution:** Has the client specifically hired the contractor personally? Or, does the contractor have an 'unfettered' right of substitution?
- **Control:** Does the client control the contractor? This considers control over the 'what', 'where', 'when' and most importantly 'how'.
- **Mutuality of obligation (MOO):** Is the contractor obliged to continually accept work offered, and is the client obliged to continually offer work to the contractor?

There are also a number of secondary factors to consider, such as whether the contractor exposes themselves to financial risk, whether they can demonstrate that they are in business in their own right, whether they are part and parcel of the client, and whether they use their own equipment to complete the job.

Crucially, IR35 status is highly subjective, and therefore requires that all factors be considered holistically, which involves analysing the 'notional contract'. This means constructing a hypothetical contract from both the written and implied terms based on the working practices. This is important, because it means a written contract could be considered a sham if it is inconsistent with the actual working practices.

What is the Off-Payroll tax?

Though HMRC has billed the Off-Payroll tax as reform to IR35, [it is entirely new legislation in itself](#). The same tests are applied to determine deemed employment status, but the Off-Payroll tax shifts responsibility for compliance and tax liability in the event of either an 'inside IR35' assessment or a non-compliant arrangement.

So, what are the key changes introduced by the Off-Payroll tax?

- **Assessing IR35 status:** The client becomes responsible for assessing the contractor's IR35 status for each engagement.
- **Tax collection:** The fee-payer* becomes responsible for calculating, reporting and processing tax via Pay As You Earn (PAYE) on payments made to contractors deemed 'employed for tax purposes'.
- **Tax liability:** The fee-payer is now liable for employer's NICs (13.8%) and the Apprenticeship Levy (0.5%) *on top* of fees paid to the contractor, as well as assuming tax liability risk in the event that HMRC challenges a deemed status.
- **Reasonable care:** If it is proven that the client hasn't taken 'reasonable care' in assessing a contractor's IR35 status, the client assumes the position of fee-payer.

*Note that the fee-payer is the party in the supply chain closest to the contractor's limited company - typically the recruitment agency. Where a client engages a contractor directly, the client automatically becomes the fee-payer.

Private sector clients meeting the criteria defining a small company in the Companies Act 2006 are exempt from applying the Off-Payroll tax rules. Where the [small company exemption](#) applies, the original IR35 rules from April 2000 (Chapter 8) will still apply, and the contractor will be solely responsible for compliance and liable for tax.

What does the Off-Payroll tax mean for contractors?

The Off-Payroll tax affects the entire supply chain. The good news for contractors deemed to be caught under the Off-Payroll tax rules is that they are no longer liable for employer's NICs which should rightfully land with their end client, being their would-be employer.

The changes also mean that contractors are not required by statute to take measures to assess their own status. However, contractors would be advised to play an active role in the process for two reasons:

1. To minimise the administrative burden on their clients
2. To ensure that they receive a fair and considered status assessment

The latter may prove a significant challenge for some contractors, whose clients may feel more inclined to deem them 'inside IR35' by default, to avoid the tax liability risk associated with an 'outside IR35' assessment. This non-compliant approach was adopted by many risk-averse clients in response to the public sector reform.

What does the Off-Payroll tax mean for clients?

The contractor's plight should be aided somewhat by the requirement that private sector clients provide a [Status Determination Statement \(SDS\)](#) at the beginning of each engagement. This is a statement which details the status determination and the reasons for having reached that conclusion.

Crucially, the SDS must demonstrate that the client has taken reasonable care when assessing the contractor's status. Failure to do so would see the client assume the role of fee-payer and its associated responsibilities and liabilities.

Though the Off-Payroll tax does pose inherent tax risks, the best option for clients is to comply and carry out their due diligence. There will be some administrative burden to bear but complying with these rules is necessary for firms to continue to attract contractors and retain access to their key skills.

Conversely, blanket assessing contractors as 'inside IR35' is likely to result in many contractors attempting to increase their rates to counter the tax hit, compounding the cost for the client.

What does the Off-Payroll tax mean for agencies?

Agencies assume the unenviable position of fee-payer under the Off-Payroll tax, unless the client is caught failing to fulfil their obligations. There will be inevitable costs for agencies in terms of getting systems in place to process fees via PAYE and report tax via RTI. However, agencies are reminded that this administrative burden is only required for contractors deemed within scope of the rules.

Though it is written into statute, the requirement that agencies as the fee-payer pay employment costs at a combined rate of 14.3% of the contract rate is neither a fair nor a realistic proposition. Most agencies simply cannot afford to cover these costs and so recruiters will have to renegotiate margins with clients and rates with contractors where a contractor is deemed within scope of IR35. This could lead to disputes.

These factors should offer recruiters sufficient incentive to promote compliance amongst parties, helping contractors to secure the 'outside IR35' contracts that they desire. Though many agencies will be looking over their shoulders in fear of the tax liability risk imposed on them by the Off-Payroll tax, compliance really is the best solution for all involved.

Firms and agencies who require help with IR35 status assessments, should consider using professional services, such as [IR35 Shield for Business](#).

Published: 12 August 2019

© 2019 All rights reserved. Reproduction in whole or in part without permission is prohibited. Please see our [copyright notice](#).

200,000+ monthly unique visitors

© Copyright 2019 Byte-Vision Limited UK. All rights reserved [Copyright notice](#)