



# 5 THINGS CLIENTS AND CONTRACTORS NEED TO KNOW ABOUT IR35

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# WHAT IS IR35 AND WHAT IS CHANGING IN APRIL 2021?

IR35 is the commonly used name given to the Intermediaries Legislation which came into force in April 2000.

In simple terms, IR35 applies to contractors supplying their services through a personal service company (PSC). A PSC can be a limited company or a partnership.

The rules' main objective is to prevent "disguised employment" tax avoidance, whereby contractors use PSC to benefit from lower corporate tax rates.

The legislation seeks to ensure that contractors working through their own PSCs pay employment taxes (PAYE) and National Insurance Contributions (NICs) where, if it were not for the PSC they work through, they would be considered as employed by the client for tax purposes (defined as "inside IR35").

Currently, in the private sector, the contractor providing services through their own PSC is responsible for deciding if IR35 applies or not for each assignment. If they perform the assessment incorrectly, it is the contractor, not the client or agency who is liable for unpaid tax and NICs.



## **From April 2021, the assessment and the liability will move up the supply chain:**

- The client will be responsible for determining whether a contractor is "inside" or "outside" IR35;
- The entity responsible for paying the contractor will be liable to account for tax and NICs (this may be the client in a direct relationship with the PSC or the agency if there is an agency in the supply chain).

# 2.

## ARE THERE ANY EXEMPTIONS AVAILABLE TO THE CLIENT?

### Small Company Exemption

The new IR35 rules will only affect medium and large private sector organisations. Small companies (as defined in s382 Companies Act 2006) are exempt.

A company qualifies as “small” if two of the following conditions apply:

- Annual turnover is no more than £10.2 million;
- Balance sheet total is no more than £5.1 million;
- Number of employees is no more than 50 individuals.

A client will cease to be medium or large-sized if it no longer meets at least two of the above criteria for two consecutive financial years.

Please note that if the client falls within the small company category, the existing IR35 working rules will continue to apply, i.e. the responsibility for making the status determination and deducting the appropriate taxes will remain with the contractor.

### Client location

Will IR35 apply to clients based outside the UK?

If the client is based wholly overseas and has no UK connection in the form of being a UK resident or having a permanent establishment in the UK, then the contractor’s limited company (PSC) will remain responsible for making the status determination and deducting the appropriate taxes.

If the client is located overseas but has a permanent establishment in the UK (a branch, an office or an agent for example), they will be required to undertake the IR35 status determination.

Guidance on what is considered a permanent establishment can be found [here](#), and further information on what is considered to be wholly overseas [here](#).

# 3.

# IS A PLACEMENT "INSIDE" OR "OUTSIDE" IR35?

## a **Making the determination – CEST Tool or RED's Tool?**

HMRC has developed an online assessment called the [CEST tool](#) (Check Employment Status for Tax). It allows clients to check the employment status of their contractors and see how HMRC would treat them (as employed or self-employed).

Alternatively, RED has developed a cost neutral IR35 assessment tool with insurance protection, that provides peace of mind and ease of transaction for its clients, whilst also diminishing exposure for all parties in the supply chain (see point 5 below for more details).

## b **Reasonable care and prohibition of blanket rules**

When clients make a status determination for each contractor assignment, they must ensure that they have taken "reasonable care", which HMRC have outlined the basic principles of [here](#).

If they do not exercise reasonable care, their status determination statement will not be valid, and they will be liable for the unpaid taxes.

One of the biggest issues regarding the assessment is a client's blanket decision to deem all PSCs' assignments as "inside IR35". Not only do such blanket assessments fail to meet the statutory obligation to take reasonable care, but it also presents a clear risk for the successful completion of current projects.

Indeed, this could result in large numbers of contractors leaving a project to clients who are prepared to assess assignments on a case-by-case basis.

Also, the contractor and the fee payer will be entitled to know how the decision was reached and will be able to challenge it.

## c **Four Key Tests**

To determine whether a contractor is "inside" or "outside" IR35, clients will have to review the following key criteria in order to establish their status.

**Mutuality of obligations:** Does the contractor have to accept the work? Is the client obliged to provide it? If the answer is yes, there is likely to be a mutuality of obligation and HMRC may qualify this relation as employment. In essence, it is an obligation between the parties to provide and accept work.

**Right of substitution for the contractor:** Is the client requiring a specific contractor to perform the services personally and would not accept a like-for-like substitute? If the answer is yes, it is likely that the contractor has no right of substitution and HMRC may qualify this relation as employment.

**Supervision and control:** Is the contractor under the supervision, direction or control of the client as to the manner in which the services are provided (except client-specific targets or project completion dates)? If the answer is yes, the contractor is not seen as being responsible for the delivery of independent services, and HMRC may consider that the client treats them as "part and parcel" of the organisation and therefore employed.

**Financial risk:** Are contractors expected to maintain appropriate business insurance, be paid only for the time worked and rectify poor quality services at their own cost? If so, the contractor is deemed as taking on a level of financial risk in undertaking the engagement which does not qualify as employment.

# 4.

There are various engagement models for the client and the contractor to choose from. It is worth taking the time now to consider them in turn. It will often depend on the type of contractor (highly skilled or not) and how critical the roles are to the client's business.

# WHAT ARE THE OPTIONS AVAILABLE?

-  **PSC contractors qualified as "outside IR35"**: RED keeps on supplying contractors using their PSC to clients, on a business-as-usual basis. To give everyone in the supply chain an added layer of comfort, RED has partnered with experts to offer IR35 insurance products mitigating the risk of an incorrect determination (see point 5 below for more details).
-  **SOW contracts**: This is an option for the highly skilled contractors RED provides. In an assignment where (i) a contractor agrees to perform specific tasks or deliver certain outcomes for a set price and within an estimated delivery time, (ii) payment is conditional upon acceptance of services or satisfactory performance, and (iii) rectification of defects or poor performance are made at the contractor's cost, there is less likelihood to be "inside IR35". Please note that not all assignments are appropriate as an SOW contract, this will depend on the client's needs.

-  **Permanent hire**: Would it make sense to offer targeted contractors full-time employment? RED can support this transition.
-  **PAYE payroll**: A contractor could convert to a PAYE engaged individual, and as a result IR35 rules will not apply. Given that take-home pay under a PAYE model is often lower than PSC rates, there is a potential risk that a contractor will terminate their assignment if the client opts for this model. Another knock-on consideration is that some individual's work permit status could be affected if they are to become PAYE temporary employees rather than self-employed PSCs – for example those working under Tier 1 Entrepreneurial Work Permits.
-  **Umbrella**: Where an umbrella company employs the worker directly, and the umbrella company withholds the appropriate taxes, IR35 rules do not apply. RED has carefully selected umbrella partners to support this model (reputable FCSA accredited companies) in order to mitigate risk and ensure compliance.
-  **Deemed model**: Should the client wish to continue to engage a contractor who is deemed "inside IR35" via their PSC, RED may support this option by partnering with JSA Group. They will take on the role of the feepayer in the supply chain such that they hold responsibility for accounting for employers' costs and "deemed salary deductions" of income tax and employees' NICs.

# 5.

## Supply chain review and communication

Clients should review their contingent workforce and assess which contractors are “business critical” and required post-April 2021.

Then, audit the types of contractors they currently use (payroll and off payroll models), the types of roles that they need to fill across their lines of business and start consulting with RED on our best approach.

It is paramount that they try to determine where their contractors are likely to land with regards to the IR35 legislation as soon as possible. RED is here to help with this process.

## RED’s solutions

### IR35 Assessment Tool

We provide IR35 status reviews using an online status determination tool produced by our partner JSA Group. This IR35 solution combines an automated review process with in-house support to give the most accurate IR35 result and guidance available.

We believe this approach is more reliable than HMRC’s CEST tool for the following reasons:

- Our status questionnaire has been developed in conjunction with Employment Law specialists to reflect current case law and provide an accurate and unbiased result;
- It automates the flow of information through the supply chain, satisfying client’s legal obligations;
- It automatically generates a Status Determination Statement (SDS) from the questions answered to evidence that reasonable care has been taken to assess the assignment;
- RED’s dedicated compliance team initiates the SDS to reduce client’s workload.

RED can support clients for both role-based determinations (prior advertisement of the role) and case-by-case determinations.

### IR35 Insurance for “outside IR35” PSC

Genuine “outside IR35” contractors represent a vibrant and increasingly important part of our economy.

They should be able to carry on working outside IR35 after April 2021 if they are authentic self-employed workers and RED is eager to support them in their journey.

We have partnered with several insurance experts in the UK to offer the most appropriate products to our contractors, ensuring adequate protection from the risks involved in an IR35 enquiry (defence costs, taxes, interest, and penalties deemed payable by HMRC).

# WHAT NEXT?

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**For more information on IR35 and how RED can help you, please get in touch with your local RED consultant today or email [info@redsapsolutions.com](mailto:info@redsapsolutions.com)**



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