

Syntax IR35 Guide

What is IR35?

- The IR35 legislation (also referred to as the ‘off-payroll’ rules), tests whether Ltd company contractors/freelancers operating through their own *Personal Service Companies* (PSCs), should be classed as ‘employees’ for tax purposes and should therefore be liable for PAYE and NI contributions.
- The legislation originally came into force in April 2000, with the intention of preventing tax avoidance through so-called ‘disguised employment’ – to prevent contractors doing exactly the same work and receiving the same benefits as permanent employees, whilst receiving the enhanced tax benefits available to Ltd companies.
- HRMC’s view is that contractors working *outside* IR35 via their own Ltd company should operate as a separate business entity, and therefore should not receive the same benefits as permanent employees. Ltd companies typically receive higher rates and lower taxes to compensate for lack of job security and other benefits such as holiday and sick pay.
- The IR35 rules initially applied to *Public Sector* organisations. In April 2017, HMRC changed the rules for the *Public Sector*, making the hiring organisation (end client), responsible for determining the employment status of contractors. From 6th April 2021, this will also apply to the *Private Sector*, with an exemption for small businesses below 50 employees or £10.2m annual turnover.
- Under the reformed IR35 rules, responsibility for determining the correct IR35 status transfers from the contractor to the *end client* (the business using the contractor). Individual contractors must be assessed and their IR35 status then communicated to the recruitment agency (fee payer), or other party contracted with the Ltd company.
- The contractor has the right to challenge the company’s IR35 determination. If the contractor disagrees, they can raise a challenge in writing. The company then has 45 days to respond to the contractor and advise whether they stand by their original IR35 assessment and why.

What Factors Determine IR35 Status?

A number of key factors are involved in determining a contractor's IR35 status. IR35 is more than a matter of simply reviewing legal contracts and T&Cs. HMRC will look at the reality of the actual working relationship between the contractor and the company, to ensure the IR35 status is an honest reflection of the day-to-day working practices of the contractor.

With an estimated 400,000 contractors operating in the UK, the process of assessing contractors' IR35 status individually has proved challenging. The following 5 factors in particular have proven to be decisive when determining IR35 status:

(1) Supervision, Direction & Control (SDC)

Can the company tell the contractor what, where, when and how the work is done? Is the contractor expected to have the skills, experience and qualifications necessary to deliver the work on an independent and unsupervised basis? This tests whether the contractor is subject to the same level of supervision, direction and control as a permanent employee.

(2) Mutuality of Obligation (MoO)

Is the contractor obliged to accept any work offered by the company? Is the company obliged to offer them work? If so, this is highly indicative of employed status.

(3) The Right to Substitute

Is the contractor obliged to perform the services *personally*, or do they have the right to send an equally skilled, experienced and qualified substitute to deliver the work on their behalf? Does the end client have the right to reject an offered substitute?

(4) Financial Risk

Is the contractor contractually obliged to correct any sub-standard, defective or negligent work at their own time and expense? Do they pay for their own Public Liability and Professional Indemnity Insurances? Do they have to cover the cost of their own training and development?

(5) Is the Contractor running a 'business on their own account'?

Is the contractor operating a genuine business with responsibility for covering its own running costs – equipment, materials, insurance or training costs? Is the contractor subject to the same appraisals and disciplinary policies as permanent employees? Do contractors benefit from the same additional benefits as employees (free gym, subsidised canteen, social events etc.)?

HMRC CEST Tool

- To help businesses assess IR35 status, HMRC has developed an online tool known as the *Check Employment Status Tool* ([CEST](#)). By answering some standard questions via an online questionnaire, the organisation can provide a written *IR35 Status Determination Statement* (SDS) for the contractor's engagement.
- The business must demonstrate that reasonable care has been taken when making the IR35 decision, and provide a copy of the SDS to the agency or contractor.
- In theory, the HMRC will stand by the result of the CEST tool. However, in practice, the CEST tool is flawed and partial, ignoring key determinants such as *Mutuality of Obligation* (MoO). This means that the CEST results are likely to be biased and inaccurate. However, it can be used by organisations to provide a 'first glance' initial IR35 assessment.

Mutuality of Obligation (MoO)

- A key component of employment law is *Mutuality of Obligation* (MoO). This means that a company is obliged to provide work to an individual, and that the individual is expected to take it. Permanent employees have MoO.
- This is a fundamental indicator of employed status. Since businesses engage contractors for a specific project or task, there is no obligation to offer additional work once the contract is complete. The contractor is hired to deliver a specific piece of work and therefore MoO does not apply.

Legal Test Cases

- Absence of MoO is a strong indicator that contractors are *outside* IR35. Many court cases and legal challenges have been won based in this test. Unfortunately, the HMRC CEST tool doesn't ask any questions about MoO, meaning that the tool is biased and likely to generate a disproportionate number of false positive results *inside* IR35.
- HMRC has a track record of losing over 90% of IR35 court cases, as tends to oversimplify the complexities of employment law. As a result, many businesses using contractors are now abandoning the HMRC CEST tool. Instead, they are making their own initial IR35 assessments internally, and following this up with assessments via qualified external 3rd party providers.

Implications

As demand for highly skilled contractors outstrips supply by a significant margin, the best contractors will be attracted to organisations who work hard to evaluate IR35 status properly, and apply due care, rather than introducing blanket 'Inside IR35' determinations. Organisations using blanket bans are likely to find it much harder to recruit highly skilled talent in the future. They may well find that their existing contractors leave to secure work elsewhere.

What are the Options?

Outside IR35 – where contractors are deemed as *outside* IR35, the company end-user can continue engaging the contractor in the same way, making payments as normal. The Ltd company will be responsible for its own tax payments.

Inside IR35 – where contractors are deemed *inside* IR35, then there are 3 possible options:

(1) Umbrella Company

The most straight-forward option for contractors *inside* IR35. The contractor works via an Umbrella/Payroll company, which will be responsible for paying the contractor, and for deducting all tax and NI. Umbrella companies typically charge a weekly/monthly administration fee to the contractor for their service. There is also scope to claim for legitimate expenses, such as travel. Contractors should strongly consider working via an FCSA accredited Umbrella company.

(2) PAYE

The contractor works directly on the payroll of the agency. The agency is responsible for deducting all PAYE tax and NI, and for processing the contractor's payments.

(3) Ltd Company (PSC)

For contractors who wish to continue working via their own Ltd / PSC company. In this instance, the *fee payer* (often the agency), becomes liable for deducting tax and NI (including Employer's NI), for the contractor and for paying this directly to the HMRC. The agency then pays the Ltd company contractor the net pay and any VAT. Due to the costs involved, most *inside* IR35 rates will be 12.5% less than *outside* rates, to account for the extra cost of Employer's NICs and the *Apprenticeship Levy*.

Next Steps

We hope you find this guide useful. IR35 is a complex and confusing issue. If you have any further questions please don't hesitate to contact us on **01332 293605** or at hello@syntaxconsultancy.com.