

↓ Key Points

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Contractor guidance on IR35 off-payroll reform in the private sector

NEW April 2022 marked the end of the 12-month grace period in which HMRC **stated** that as a way of supporting organisations that are trying to comply with the new rules, financial penalties would not be issued for any inaccuracies provided that there is no evidence of deliberate non-compliance. As the grace period has now come to an end, APSCo recommends that members review our guidance and **other resources** to ensure that they are operating in compliance with the off-payroll working rules.

Background

The reform of the off-payroll working rules (known as IR35) came into force in April 2021. This followed the roll-out of the reform in the public sector and the Chancellors announcement in Budget on 29th October 2018 that the government will also reform the off-payroll working rules in the private sector.

The reform moves the responsibility for operating the off-payroll working rules from individual contractors to the organisation, recruitment business or other third party contracting with and paying the contractor (the “fee-payer”).

You can access guidance and webinars on the off-payroll changes on the governments **[‘Resource and support for off-payroll working’](#)** page. This includes information specifically catered towards clients and the **[Employment Status Manual \(ESM10000\)](#)** is particularly helpful and should be your “go to” reference guide.

When the off-payroll working rules (“IR35”) apply

The off-payroll rules apply if a worker provides their services to a client through an intermediary (your personal service company (PSC)) but would be classed as an employee if they were contracted directly with the client. Before 6 April 2021, if your client is in the private sector, it’s your limited company’s responsibility to decide your own employment status for each assignment.

As of 6 April 2021, the rules changed. All public sector authorities and medium and large-sized private sector clients with a UK connection will be responsible for determining whether or not the rules apply – i.e. are you “inside IR35” or “outside IR35”? Where the private sector client is considered “small” or has no UK connection, your limited company will remain responsible for deciding the contractor’s employment status and whether IR35 applies.

Where off-payroll is applicable and the client makes the status determination as inside, the contractor’s fees will be subject to tax and National Insurance contributions. These deductions will be levied by the “fee-payer” which is the entity who holds the contract with your limited company, typically this is the recruitment business.



Small Company Exemption

The new off-payroll rules only affect medium and large private sector organisations with a UK connection and the public sector, so “small” private end clients are exempt - the definition of which is based on the Companies Act 2006 definitions. The government anticipates the changes will not apply to the smallest 1.5 million businesses, which may need flexible resource.

The existing off-payroll working rules will continue to apply for assignments if you are providing services to a client classed as a “small” company, meaning that the responsibility for making the status determination remains with the PSC.

Under section 382 of the Companies Act 2006, a client qualifies as “small” if two of the following conditions apply **for two consecutive financial years:**

1. Annual turnover Not more than £10.2 million
2. Balance sheet total Not more than £5.1 million
3. Number of employees Not more than 50 employees

Please note that **the small company exemption applies to the end client**, not the fee-payer or the PSC.

Client duty to confirm size upon request

Section 60H Chapter 10, Part 2 ITEPA 2003 sets out a requirement for clients to state, in their opinion, if asked, whether it qualifies as “small” in a tax year. The “client’s agent” (the agency/recruiter with whom the client has a contract) or the worker can make the request if they meet the following conditions:

- the worker personally performs, or is under an obligation to perform services for the client;
- the client is not a public authority; and
- the services are provided under arrangements involving a third party (‘the intermediary’) and not under a contract directly between the client and the worker.

The client must respond to size-related information requests for the relevant tax year within the later of 45 days of receipt and if they fail to do so within the time limit, the party can apply to court for an injunction, or an order for specific performance in Scotland.

Making the status determination - “inside IR35” or “outside IR35”

As of 6 April 2021, it is the client’s responsibility to determine whether the off-payroll working rules apply, i.e. is this assignment “inside IR35”? You can refer to the [HMRC guidance and the employment status for tax \(CEST\) tool](#). Although much criticised, the CEST tool does give you a good steer of the approach taken by HMRC and the indicators that they are looking for. As promised, HMRC have enhanced the CEST tool and published the [ESM11000](#) which provides guidance on the specific questions.

Assignments “Outside IR35”

When the client makes the status determination that an assignment is “outside IR35”, they must ensure that **“reasonable care”** was taken during the decision-making and that the decision itself is reasonable. If the client does not exercise reasonable care, the status determination statement will not be valid, and the client will



be liable for the unpaid taxes. HMRC have published [guidance](#) in their Employment Status Manual which outlines the basic principles of what constitutes “reasonable care”.

Assignments “Inside IR35”

If the client determines that an assignment is “inside IR35”, you need to understand what options are available in terms of an alternative to an off-payroll model. The options are:

- **PAYE payroll (agency workers)** - Where a recruitment business *contracts* directly with the worker and operates tax and NICs under agency rules and provides the workers with worker rights - the off-payroll working rules do not apply.
- **Umbrella Company** - Where an umbrella company *employs* the worker directly, the off-payroll working rules do not apply.
- **“Inside IR35” PSC** - Should you wish to continue to engage as a contractor via your PSC who is deemed “inside IR35”, your recruiter will need to calculate a “deemed employment payment” using the RTI (Real Time Information) payroll system. The deemed employment pay rate is the income of the worker after deductions, including both employee and employer NICs and the Apprenticeship Levy. Neither worker rights nor stakeholder pension rights apply. No expenses allowance applies.

Incorrect determination

If the off-payroll proposals are legislated in their current form, where HMRC disagrees with the determination made, it can investigate and insist on back payment of tax, as well as fines for late payment from the fee-payer.

Frequently Asked Questions

I work for lots of clients, does IR35 still apply?

The off-payroll working rules will still apply irrespective of how many clients and assignments a contractor is working on. There is the argument that if you are working on multiple projects for various clients, this will demonstrate that you are in business on your own account as an independent contractor, and therefore fall “outside IR35”. However, your IR35 status is assessed on an assignment basis – working for multiple clients is not a significant indicator of being in business on your own account; the IR35 status for each assignment is judged on its own merit.

The client does not understand/will not apply the new IR35 rules, do I need to worry?

As of April 2021, all public sector authorities and medium and large-sized private sector clients with a UK connection will be responsible for deciding whether IR35 applies. If the client either 1) fails to make a status determination, 2) fails to pass the status determination down the supply chain, or 3) fails to take reasonable care when making the status determination; the client may be liable for the tax and NICs as the deemed “fee-payer”.

The legislation is now clearer on when an unpaid PAYE debt payable by a deemed employer (the fee payer) can be recovered from others (relevant persons) (Schedule 1, Part 3, Paragraph 19 of the Finance Act 2020 amendment to S688AA ITEPA 2003). If an HMRC officer considers there is “no realistic prospect of recovering from the deemed employer within a reasonable period” then HMRC can recover from the highest person in the chain or the second highest person in that chain, where that agency is also resident in the UK.

It is important that clients exercise reasonable care when making a status determination, given the issues that arose from the public sector reform in April 2017 as a result of blanket “inside IR35” determinations.



If you are providing services to a small private sector client, they will be exempt, and they are not required to follow the new IR35 rules. Your PSC will remain responsible for determining your IR35 status and making the appropriate tax deductions and NICs.

Can I convert to working under a Statement of Work (SOW) contract?

We have concerns about converting a current time and materials contract to a SOW contract as the contract must accurately represent the reality of what happens during the assignment. However, for new assignments with new clients this is an option for highly skilled contractors.

In an assignment where a contractor agrees to perform specific tasks or deliver certain outcomes for a set price and within an estimated delivery time, there is less likelihood of the client exerting control over the individual. A Statement of Work (SoW) contract, if appropriately executed, is likely to be “outside IR35”, compared with the traditional time and materials-based contract on a set hourly or day rate.

It is more likely that an assignment will fall “outside IR35” if the performance of the services carries a genuine business risk, e.g. payment is conditional upon acceptance of services or satisfactory performance, and rectification of defects or poor performance are made at the contractor’s cost. Although this may seem like an easy option to adapt to the new rules, you will remain at risk if the reality of the contractual performance does not reflect the contractual wording. Please note that not all assignments are appropriate as a SoW contract, this will depend on whether the recruiter and the end client offer this option.

The client is based outside of the UK, does IR35 apply?

Where the medium and large-sized private sector client is based wholly overseas and has no UK connection in the form of being a UK resident or having a permanent establishment, your limited company will remain responsible for deciding the contractor’s employment status and whether IR35 applies. The legislation on permanent establishment for a company can be found [here](#) and guidance [here](#).

Can I be involved in the client’s status determination?

It is expected that you will be involved to some degree in the client’s status determination process, as there are some questions in the HMRC CEST tool which require the contractor’s input – for example questions on how you run your business. However, there is no statutory right for a contractor to be consulted during the status determination process.

I do not agree with the client’s status determination, can I appeal it?

Representations that the status is incorrect can be made by the worker or deemed employer any time up to when the final chain payment is being made for an engagement (Section 61T (1) Chapter 10, Part 2 ITEPA 2003). The client must give a statement to the worker or the deemed employer (depending on who made the representation) that either the SDS is correct with reasons or give a new SDS, stating the date from which the client considers that the conclusion in the new SDS became correct and stating that the previous SDS is withdrawn. The deemed employer is deemed to have received the reply from the person above it in the chain of supply.

The client has 45 days beginning with the date the client receives the representations to respond. If it fails to meet that deadline then from that date on it carries fee payer liability until it complies.

Will my rate be affected by the new rules?



If your assignment falls “inside IR35”, the take-home pay will be less as the recruiter has a statutory duty to deduct the appropriate tax and NICs. Be aware that historically, PAYE rates have always been lower than PSC rates so you may find that in future pay rates offered are lower.

Can I be forced to pay for employer’s NICs?

Recruitment businesses cannot lawfully deduct secondary NICs from an agreed fee, but recruitment businesses may adjust the contractor’s pay rate to factor in the additional costs of supply which include employers’ NICs. Depending on your contractual terms, there may be scope for the rate to be negotiated accordingly.

Do I get employment rights if I am “inside IR35”?

Should you wish to continue operating as an “inside IR35” contractor through the deemed employment method, you will not benefit from any “employee rights” such as holiday pay, sick pay, pension contributions, dismissal rights etc. You may receive these benefits through your employment in your PSC.

If your assignment falls “inside IR35”, it is likely that you are no longer in business on your own account and could be within scope of the Agency Worker Regulations (AWR). Under AWR, you are entitled to comparable pay to a permanent employee on the client site. If you opt to engage via an umbrella company, you are an employee of the umbrella company and therefore you will benefit from employment rights and AWR will apply.

My assignment is for 2 years – is it automatically “inside IR35”?

The 24-month rule is in reference to claiming travel expenses. This rule has no bearing on the IR35 status of an assignment.

Can I set up a shared PSC to facilitate my right of substitution?

There are suggestions that contractors could set up a limited liability company with a small group of contractors to allow them all to effectively exercise their right to substitution. This could be a practical way of operating provided that all of the contractors are directors and shareholders and collectively control the business. This will need serious consideration and bespoke advice.

APPENDIX 1

Determining whether the assignment is inside or outside IR35

To determine whether a contractor will be caught by IR35, key criteria are reviewed to establish employment status. A decision is made about a hypothetical contract between the contractor and the end-client, and whether, if those two parties were contracting directly, there would be an employment relationship. However, the route to determining employment status is fact-specific and in some cases, there is no clear outcome.

It is worthwhile working through [HMRC’s employment status for tax test](#) and entering different responses to gain an understanding of the different outcomes. This tool is often used in the public sector when establishing IR35 status. Essentially, if a contractor has similar working conditions, responsibilities and control as an employee of the client would have, then they are likely be classed as “inside IR35” (i.e. the off-payroll working rules apply). Case law is evolving constantly in the tax tribunals, courts and employment tribunals but the key factors that determine a contractor’s IR35 status are as follows:

- **Substitution**



A genuine right of substitution has long been deemed to be a very important factor when demonstrating that a contractor's assignment falls "outside IR35". For a substitution to be considered valid, the right to supply a substitute must be a genuine one. This means that the client must agree to it in practice, the contractor must pay for the substitute, and it should be an unfettered right. An unfettered right of substitution means that a client must accept a substitute if the initial contractor is unavailable. HMRC have now qualified the criteria within the CEST question on substitution, which states that a client's need to be satisfied that the substitute has the skills and experience required or to ensure the substitute is approved under their security processes - this does not negate the right of substitution.

- **Control and Direction**

In most cases where professional services are provided, it is important that a contractor can demonstrate a certain amount of autonomy in the way they undertake a project. Both the written contract and working practices must show that the client has no influence over how the contractor performs their services.

Control factors that may point towards an "inside IR35" status include:

- Indicating that the contractor will be supervised;
- Including any "staff" benefits (including holiday or sick pay);
- Including start/end/break times; and
- Contractual clauses that specify any rights of control or supervision over the contractor.

The reality of the situation is that the individual is responsible for the delivery of the services. The individual will determine and control how and when they provide their services to the client, provided that they meet client-specific targets or project completion dates. It is worth noting that any clauses referring to control should be reflected in both the first-tier (between recruitment business and client) and the second-tier contracts (between recruitment business and contractor).

- **Financial risk**

The contractor may take on a level of financial risk in undertaking the engagement. Contractors who do not take any financial risk, for example don't have to rectify poor quality services at their own cost, are more likely to be "deemed employees" for tax purposes. Contractors taking financial risk would also be expected to maintain appropriate insurances.

- **Mutuality of Obligation**

This is a hotly disputed area of law, as the position of HMRC is different from that of many practitioners and case law. In essence, it is an obligation between the parties to provide and accept work. In an employer/employee relationship, mutuality of obligation is easy to establish. However, in client/contractor relationships, it is less clear. HMRC states that by having a contract agreeing to provide services, mutuality is established but most experts consider the legal picture to be more complex.

Other factors include:

- Provision of equipment;
- Any absence procedures;
- Continuity of the engagement;
- Termination agreements;
- Notice periods; and
- If the contractor has become "part and parcel" of the organisation.

HMRC produced a [technical note](#) in 2017, which contained several illustrative scenarios. Below are two obvious examples:

HMRC Examples	
Off-payroll working rules apply	<p>Rebecca works through her own PSC as an IT product designer at the Ministry.</p> <ul style="list-style-type: none"> - Rebecca will be working at the Ministry's IT development centre; - She is not required to supply her own equipment; - Rebecca will work under the direction of a senior manager; - Flexible working hours are available, but Rebecca will need to agree time off with her manager.
Off-payroll working rules do not apply	<p>Jasmine is a Website Designer, contracted to a large local authority through a PSC to design and build a website. She will:</p> <ul style="list-style-type: none"> - Deliver the website to an agreed standard by the agreed date; - Visit the council's offices for meetings, but mainly work from own office; - Provide her own equipment needed to do the job in hand; - Employ her own staff to help deliver the contract if she needs to; and - Cover her own costs and expenses. <p>She is not filling a role, but rather providing a whole service, the fee for which covers her equipment, time and staff costs (should she want/need to engage others to assist on the project).</p>

HMRC have published the Employment Status Manual ([ESM10000](#)) which provides technical guidance on the upcoming rules.

Disclaimer

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