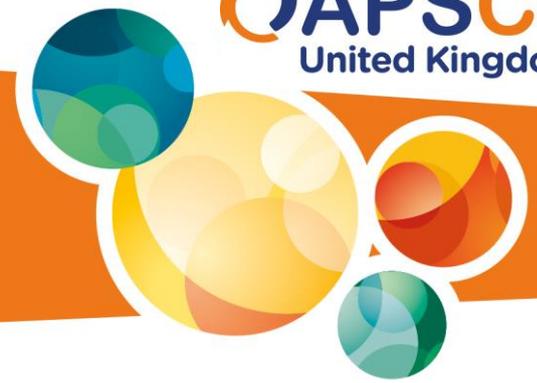


APSCo Frequently Asked Questions on IR35



UPDATED July 2022

NEW When did the IR35 grace period come to an end?

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.

What is IR35?

IR35 is the name given to tax legislation in the Income Tax (Earnings and Pensions) Act 2003 (ITEPA). It applies to individuals supplying their services through an intermediary, usually a personal service company (PSC). The IR35 legislation seeks to ensure that contractors working through their own PSCs pay employment taxes and NICs where, were it not for the PSC they work through, they would be employed by the client, commonly known as “inside IR35”.

If IR35 applies, then PAYE and National Insurance contributions are deducted from the rate. This prevents the contractor being paid a minimum salary, up to the limit of their tax-free allowance and leaving the rest in the company. If money is withdrawn from a company as a dividend, although tax is due at the dividend rate, there are no NICs payable.

When does IR35 apply?

IR35 applies where the worker operates through a UK limited company, irrespective of the location of work.

If you engage and supply contractors who work via an intermediary (typically a PSC), where taxes and NICs are not deducted at source, then you are likely to be affected by IR35.

How can we assess the employment status of a worker?

HMRC provides an employment status tool, which you can find [here](#), with [supporting guidance](#). The CEST (Check Employment Status for Tax) tool was developed to assist with applying the off-payroll rules, allowing you to check the employment status and see if HMRC will treat you as employed or self-employed for tax purposes.

Here is a list of some of the factors considered when assessing employment status and whether or not an assignment would be inside or outside of IR35 (this is not exhaustive):

APSCo Frequently Asked Questions on IR35

- The contractor is not under supervision, direction or control of anyone in the supply chain as to the manner in which the services are provided. The contractor provides independent services, and the client does not treat them as if they are “part and parcel” of their organisation.
- The reality of the situation is that the contractor is responsible for the delivery of the services, and determines, and controls when and how they undertake the work they do for the client, as long as they meet client-specific targets or project completion dates.
- The contractor does not have to perform the work or services personally, and the client has to accept a substitute (subject to that substitute having the requisite skills and capabilities).
- The PSC maintains adequate business insurances.
- The PSC submits invoices for work completed or agrees to a self-billing arrangement.
- The PSC is responsible for paying the required taxes and statutory deductions on amounts paid in respect of the work undertaken. All amounts are treated as trading income.
- The contractor/PSC is only paid for services performed. There are no payments made for any time when the contractor is not available for work (including but not limited to holiday pay or sick pay). The client has no liability to pay for any periods during which the contractor is not providing their services.
- It is important to consider the factual reality of an assignment, not what the contract says.

Can I rely on the status determination produced by CEST?

HMRC have said that if the parties use the employment status tool and input information which is accurate and honest, and the answers remain accurate during the contract, then HMRC will stand by the outcome. However, there is a level of scepticism as to whether this will be the case – the CEST result is not a form of clearance. Parties need to ensure they do not over rely on the substitution clauses if they use CEST to make the determination. If the client says there is a theoretical right to substitution, but other responses do not support self-employment then it is unlikely to be an “outside IR35” assignment.

Many of our members are choosing to work with third party suppliers offering independent IR35 assessments, with insurance protection. Some of our Trusted Partners are offering these services and we have published specific [updated information](#) for explaining what is being offered.

What were the IR35 changes in the public sector (off-payroll rules) from 6 April 2017?

In April 2017, HMRC introduced the off-payroll working rules in the public sector. The off-payroll legislation imposes an obligation on the public sector body (“PSB”) to inform the party it contracts with of the status of the contractor, and whether or not a contractor would be regarded as an employee or office holder of the client were it not for the contractor’s PSC being in the contractual supply chain (i.e. “inside IR35”).

The changes apply to almost all placements in the public sector. A public sector client for the purpose of the changes means those listed as a public authority under the Freedom of Information Act 2000 (2002 Scotland Act). The public sector client must provide information to a recruitment firm as to whether the employment

APSCo Frequently Asked Questions on IR35



status test is met, namely whether an assignment is in scope of the rules or not. The party with the direct responsibility for paying the PSC (the fee-payer) will have ultimate responsibility for running the payroll. In most cases where a recruitment firm is involved it will be the recruitment firm paying the PSC, not the Managed Supplier or Vendor Manager. The fee-payer will carry the liability for the decision. For further details, please review [APSCo's member guidance on the off-payroll working rules in the public sector](#).

The changes in April 2021 also apply to the public sector.

What are the IR35 changes in the private sector (off-payroll rules) as of 6 April 2021?

Previously in the private sector, the intermediary (the contractor's PSC) was responsible for deciding if IR35 applies.

Since 6 April 2021, the responsibility for operating the off-payroll working rules have moved from contractor to the client organisation, recruitment business or other third party engaging the contractor - referred to as the "fee-payer" in the legislation. Both private sector clients and public sector clients will be responsible for deciding the IR35 status of an assignment. This change will only affect medium and large-sized private sector organisations as there is a "small" company exemption, with a UK connection.

For further details, please review [APSCo's member guidance on the off-payroll rules in the private sector](#).

What is the "small" business exemption?

The new IR35 changes affect all public sector clients and medium and large private sector clients only – "small" private sector businesses are exempt. The definition of "small" is based on the [s382 Companies Act 2006](#) definition. The off-payroll working rules contained in [Chapter 8, Part 2 ITEPA 2003](#) will continue to apply for assignments if the client is a "small" business, meaning the responsibility and liability for making the status determination and deducting the appropriate taxes and NICs remains with the PSC.

A company qualifies as "small" if **two** of the following conditions apply **for two consecutive financial years**:

- Annual turnover** – no more than £10.2 million;
- Balance sheet total** – no more than £5.1 million; and
- Number of employees** – no more than 50 employees.

The 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.

APSCo Frequently Asked Questions on IR35



In determining the average number of employees, you should only include those directly employed by the company, therefore this would not include deemed employees i.e. PAYE agency workers. [ESM1006](#) has further detail available to help clients determine the size of their organisation in line with the above requirements.

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

How do I get the client to confirm their size?

Section 60H Chapter 10, Part 2 ITEPA 2003 sets out a requirement for clients to state, in their opinion, if asked, whether they qualify as “small” in a tax year. The “client’s agent” (the agency/recruiter with whom you have 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 45 days. The end of the 45 days would be the later of; a) the end of the 45 day period beginning with the date the request is received, or b) 45 days prior to the start of the tax year specified in the request.

Should the client fail to respond to the request by the deadline, the requestor can apply to the courts for an injunction (or an order for specific performance in Scotland). HMRC have suggested templates available for your clients to confirm their size in [ESM10011B](#).

What if the client is a part of a group?

Where the company is a part of a group, the size will be determined on its parent company. There is further detailed information available in [ESM1007](#).

A client’s company will qualify as ‘small’ in its first financial year following incorporation, even if it is a part of a group. They will remain small until the beginning of the first tax year, after the period for filing its accounts for the first financial year has ended.

Do the new IR35 rules only apply to services performed after 6 April 2021?

The new rules will only apply to **payments made for services provided on or after 6 April 2021**. Previously, the new rules would have applied to any payments made to the PSC on or after 6 April 2021 irrespective of when the services were performed or the invoices were raised.

APSCo Frequently Asked Questions on IR35



HMRC Example

Alexi provides his services to a medium-sized client from the 23 March 2021 to 17 April 2021. Alexi works eight hours a day, Monday to Friday and operates through a PSC. Alexi would be employed if engaged directly. There are ten working days before 6 April 2021 and ten working days on or after 6 April 2021. The payment for these services is £2,000, so £1,000 of this (10/20 days) is subject to Chapter 8, Part 2 ITEPA 2003 and the other £1,000 (10/20) is subject to the new rules.

If a contractor falls “inside IR35” from 6 April 2021 and starts paying tax and NICs, will this automatically trigger an enquiry into previous assignments?

HMRC have decided to only use information resulting from the new off-payroll rules to open any new compliance checks into the returns for earlier years if there is a reason to suspected fraudulent or criminal activity.

HMRC will focus on ensuring businesses comply with the reform for new engagements, rather than focusing on historic cases. Organisations’ decisions about whether workers are within the rules will not automatically trigger an enquiry into earlier years, this is confirmed in [ESM10036](#).

My client is based outside the UK, but is engaging a contractor who is a UK tax resident and operating through a UK limited company – 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 in the UK, the worker’s limited company (PSC) will remain responsible for deciding the contractor’s employment status and whether IR35 applies. Guidance on what is considered a permanent establishment can be found [here](#), and further information on what is considered to be wholly overseas can be found in HMRC’s employment status manual [here](#).

What is a permanent establishment?

As explained in [INTM153060](#), the basic definition of a permanent establishment is a fixed place of business through which the business or the client is wholly or partly carried on. Where the client has a UK subsidiary, it may be considered as a permanent establishment if it carries on the business of the foreign parent company as a dependent agent in addition to its own business.

Determining whether a permanent establishment exists is complex, therefore it is recommended your client gets external advice if needs be.

The client has determined that the assignment is “inside IR35”, what are the options?

If an assignment is determined as “inside IR35”, there are various alternative engagement models to an off-payroll model:

APSCo Frequently Asked Questions on IR35



PAYE payroll (agency workers) - Where a recruitment company contracts directly with the worker and operates tax and NICs under agency rules and provides the workers with worker rights, IR35 off-payroll rules do not apply. If you do decide to engage workers directly, AWR applies and the Swedish derogation was abolished in April 2020.

Umbrella Company - Where an umbrella company employs the worker directly, the off-payroll working rules do not apply. Some umbrella companies do not employ the worker directly and use intermediaries, so ensure that this is checked as you may unwittingly enter into a PSC contract where the off-payroll working rules will apply.

"Inside IR35" PSC – Should you wish to continue to engage a contractor who is deemed "inside IR35" via their PSC, you 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.

What is Statement of Work?

A Statement of Work (SoW) is a document, typically used in project management, which defines a set of project-specific activities, deliverables and timelines for a contractor providing services to a client.

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 contractor. A 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 also depend on whether the client offers this option.

How does a consultancy model work?

Consultancy work is where you take responsibility for the delivery and quality of the services, this may involve taking on a larger project and sourcing expert contractors to deliver the work. This will require you

APSCo Frequently Asked Questions on IR35



to expand your insurance coverage and a consultancy model is particularly risky if you don't have the internal expertise on the type of service are you providing - you may need to hire a project manager.

Where you are delivering a true outsourced consultancy service to your client, under the new IR35 rules from April 2021, you will be viewed as the client for the purposes of making the IR35 status determination rather than the client. This is because you are **supplying a service** to your client (e.g. building a website), as opposed to a **supply of labour** (e.g. a contractor providing IT services), so you are the last party in the supply chain receiving a supply of labour.

APSCo recommends that you seek independent advice if you are considering operating as a consultancy. APSCo have precedent consultancy terms which can be made available to members after a discussion with them about how they intend to run the model. This is to minimise the risk of members mis-using the terms and raising both their own and their clients' risk of non-compliance.

If a contractor works for lots of different 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. Where a contractor is working on multiple projects for various clients, and is not financially dependent on any one client, then this is evidence that they are in business on their own account as an independent contractor, which supports an "outside IR35" assessment, forming part of the overall picture.

However, IR35 status is assessed on an assignment basis.

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

As of 6 April 2021, all public sector authorities and medium and large-sized private sector clients with a UK connection are 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 or 4) upon transfer of debt; the client will be liable for the tax and NICs as the deemed "fee-payer".

Members are advised to engage with their supply chains (clients and contractors) regarding the new rules to help to ensure that all parties are prepared for assignments post-April 2021. 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 engaging with a small private sector client, they will be exempt, and they are not required to follow the new IR35 rules. The contractor's PSC will remain responsible for determining their IR35 status and making the appropriate tax deductions and NICs.

APSCo Frequently Asked Questions on IR35



What constitutes a valid Status Determination Statement (SDS)?

For an SDS to be valid, the client must ensure they:

- confirm whether the worker would be an employee/office holder, or is an office holder for tax and NIC purposes if they were directly engaged by the client;
- provide reasons for coming to the above conclusion; and
- have taken [reasonable care](#) in coming to their conclusion.

The outcome document of a test, whether CEST or a commercial tool, can in itself be the SDS as long as it is sent to the next party in the supply chain and the worker. There is further information available in [ESM10013](#).

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

The legislation imposes an obligation on the client to provide a "client-led status disagreement process", either the recruiter or the contractor may disagree and follow the process. The client must respond to a request to review the status determination statement within 45 days. The client must either confirm that the determination is correct, with reasons, or provide a new status determination statement reaching a different conclusion and withdraw the previous one.

If you are the fee payer and disagree with the client's determination, you will need to write to the client and give reasons why. You need to ensure you keep records of status determinations and any corresponding disagreements. During the dispute process, the client's status determination stands. Further information can be found in [ESM10015](#).

My client is making blanket determinations for all contractors, can I accept this?

One of the biggest issues to arise from the public sector reform in April 2017 was blanket "inside IR35" determinations. This resulted in a large number of contractors being moved into umbrella arrangements. It became clear that such a blanket assessment would not meet the statutory obligation to take reasonable care when making an IR35 status determination. Clients can take a role-based approach if they have a number of contractors working on the same contract on similar terms and conditions.

Please note that clients choosing not to engage with PSCs in their supply chains is not the same as making a blanket determination.

APSCo Frequently Asked Questions on IR35



How will payrates be affected by the new rules?

If an assignment falls “inside IR35”, the take-home pay will be less as you have a statutory duty to deduct the appropriate tax and NICs. Be aware that you cannot deduct employers’ NICs from an agreed rate, as this would constitute an unlawful deduction of wages. However, recruiters can review and renegotiate rates to factor in the additional costs of supply, such as employers’ NICs, but this must be evidenced in a reissued contract/schedule.

Historically, PAYE rates have always been lower than PSC rates. However, some contractors may try to negotiate a higher fee to offset their tax and NICs, we advise that you assess the criticality of the contractor workforce when reviewing rates and margins.

Can I pass on employers’ NICs to the contractor?

Recruitment businesses cannot lawfully deduct employers’ NICs from an agreed fee, but recruitment businesses may review 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.

Are “inside IR35” contractors entitled to employment rights?

Should a contractor choose to continue operating via their PSC although the assignment is “inside IR35”, they will not benefit from any “employee rights” such as holiday pay, sick pay, pension contributions, dismissal rights etc. Contractors receive these benefits through their employment in their PSC.

If an assignment falls “inside IR35”, it is likely that the contractor is no longer in business on their own account and is within scope of the Agency Workers Regulations (AWR). Under AWR, workers are entitled to comparable basic pay and conditions to a permanent employee on the client site. If a contractor opts to engage via an umbrella company, they will be an employee of the umbrella company and therefore they will benefit from both employment rights and AWR rights.

What is the “2-year rule” and does it apply to IR35?

The 24-month rule is in reference to claiming travel and subsistence expenses using a contractor’s home or office as their main working location and the client site as a temporary workplace. This rule has no bearing on the IR35 status of an assignment.

The “24-month rule” applies to travel and subsistence tax allowances under **S339 (3), (5) and (6) of ITEPA 2003**. Travel and subsistence allowances are relevant if an assignment is “outside IR35”. If an assignment is “inside IR35” then the contract workplace is deemed to be a permanent workplace, meaning there is no expense allowance.

APSCo Frequently Asked Questions on IR35



Even when a contractor attends a client workplace for more than 40% of their time (called a period of continuous work), for example, the standard five-day working week, it will be a temporary workplace if the overall assignment is for less than 24 months. However, if the assignment lasts more than 24 months then expenses are no longer tax deductible.

If an assignment is likely to last more than 24 months, then expenses are not allowed from the time when the parties knew it was likely to extend over 24 months. For example, a contract of 17 months is extended for 12 months. No travel costs and subsistence will be tax deductible from the start date of the extension not from the 24-month anniversary.

Can we engage with a shared PSC?

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. Contractors will need to take serious consideration and bespoke advice on this. Recruiters should conduct your usual due diligence when engaging with a PSC to guarantee that the PSC is compliant one and therefore not exposing you to any tax risks. **Please see here a flow chart of compliance checks for working with PSC contractors.**

You should ensure that neither you nor your personnel are actively facilitating and controlling models devised to avoid IR35 or ensure an "outside IR35" assessment as this could fall foul of HMRC's general anti-abuse rules (GAAR) or be at risk of liability under the Criminal Finances Act.

What if I'm operating through CIS?

The off-payroll rules take precedence over CIS, therefore if the rules apply you would not need to consider applying the CIS rules on payments made. If the party receiving the workers services benefits from the small company exemption, then the workers intermediary would be responsible for considering whether the off-payroll rules apply.

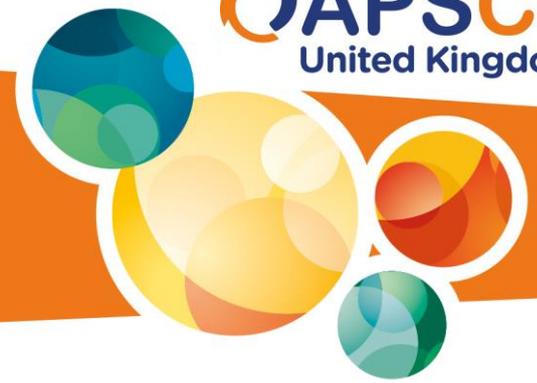
What is a TAAR?

The Targeted Anti-Avoidance Rule (TAAR) was introduced to help target arrangements where the main purpose is to gain a tax advantage by getting around the conditions of an 'intermediary' to take the engagement out of scope of the off-payroll rules. Further detail can be found in [ESM10003B](#).

Does APSCo provide specific model contracts for both "inside IR35" and "outside IR35"?

APSCo does not offer specific "inside IR35" and "outside IR35" contracts for engaging with contractors.

APSCo Frequently Asked Questions on IR35



Our [model contracts](#) include relevant provisions for “outside IR35” assignments (i.e. substitution, control, financial risk etc), however there are clauses in place that where you have an “inside IR35” assignment, the contract is suitable for use and the appropriate clauses will come into effect.

We have a [guidance](#) available on the website on key IR35 clauses in the APSCo Agreement for Contractors.

If you have any queries, please contact the legal helpdesk at legalhelpdesk@apsco.org.