



Managing the impact of IR35

A proposal from Liberas Solutions Ltd

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Background

Two recent sets of tax legislation have been drafted that are designed to combat tax avoidance by workers, and the firms hiring them.

The idea is to combat a scenario where a firm hires someone as a contractor via their limited or intermediary company, but if the intermediary was not available they would be an employee. HMRC call these workers 'deemed employees'

IR35 can reduce the worker's net income by up to 25%, costing the typical limited company contractor thousands of pounds in additional income tax and NICs.

Government is replacing the original IR35 legislation with **the new Off-Payroll Tax**, which was initially introduced into the public sector in April 2017, and will be extended to the private sector from April 2020.

For firms that hire contractors, where the new Off-Payroll Tax needs to be considered, they shouldn't fear the new legislation, provided they take the correct steps when hiring and engaging their contractors.

In April 2017 the Government introduced the "Off-Payroll Reforms", which is a separate piece of new tax legislation that applies to the public sector, but which is also, albeit confusingly, referred to as "IR35."



Whilst they both contain the common theme of "deemed employment", the newer rules introduce a different set of tax treatment, meaning that firms will now have to assess the contractor's status, but, more importantly, pay employment taxes *on top* of the fees paid to the contractor. This new tax is now widely referred to as the "Off-Payroll Tax"

How IR35 works - the tests of employment

The link below takes you through the online checks HMRC will require you to make to decide whether a contract falls within our outside IR35 rules.

<https://www.tax.service.gov.uk/check-employment-status-for-tax/determination>

A precise and expert knowledge of employment law is required to fully interpret these test and it's unfair to expect independent professionals being investigated nor HMRC's tax inspectors, and nor hiring clients become experts in decades of employment status case law.

Determining whether you are caught by IR35 is complex, and ideally you should seek expert IR35 advice. However, there are a number of online links where you can check employment status on a case by case basis.

There are some simple checks you can do without much effort.

The 6 checks below help get a good indication whether a contingent worker's contract fall within or outside IR35:



Control: Is the worker free to work as they wish? For example, are they required to work from a certain location or at certain times of the day at the request of the client?

Financial risk: Is there a personal financial risk incurred as a result of the performance of work duties? Employees rarely risk financial loss by being employed, whereas if a worker buys assets such as PC's, laptops, servers, printers, office equipment or a client fails to pay, a contractor or freelancer will most definitely experience financial loss.

Substitution: Is there a clause in the contract around using somebody else to perform the task given to the worker? Is someone else allowed to step in and cover the job?

Provision of equipment: Will the worker be using their own equipment? Sometimes this can be difficult with organisations stipulating that company-owned equipment must be used at all times. Allowances can be made where security measures prohibit the use of someone using their own laptop for example.

The right of dismissal: Does the worker have a fixed notice period? HMRC will argue that this is like an employee, therefore there should be a provision in the contract for immediate termination should the client choose to do so.

Employee benefits: In simple terms, receiving holiday pay, sick pay, pension contributions and training courses are all no-go areas. These benefits should only apply to employees of the company - not contractors or freelancers.



These are the principals for ‘tests of employment’:

- **Control:** what degree of control does the client have over what, how, when and where the worker completes the work.
- **Substitution:** is personal service by the worker required, or can the worker send a substitute in their place?
- the employer is obliged to offer work, and the worker is obligated to accept it.

How has the market reacted



We have seen the market react in a number of ways and it’s fair to say business has had to fill the void where there is a lack of advice and direction from central government



Business using contingent workers have taken a number of different mitigating steps such as:

PAYE enforcement

- Contractors on current projects are being told the T&C's of their contracts will change and they must accept a PAYE arrangement or leave the client
- The PAYE arrangement is typically be managed using an umbrella company arranged and managed by the client or the contractor themselves
- This has the net effect of reducing the contractors take home pay but roughly 20% as the client/umbrella company will reduce their gross income by income tax, employee's NI contribution, employer's NI contribution and apprentice levy tax
- Many contractors faced with this prospect are choosing to leave the contract and seek alternative employment

Ban on the use of all contractors

- Some businesses have chosen to enforce a blanket ban on the use of contingent worker
- This is not within HMRC guidelines as they will expect businesses to conduct individual assessments to decided whether a role is within or outside IR35
- In this instance business are faced with the choice to replace contingents with permanent staff assuming they can recruit in time OR postpone/cancel any work the contractors in question were working on



Ban on the use of UK contractors

- Some businesses have chosen to remove all UK based contractors from their projects - replacing them with workers on non-UK contracts
- Obviously this forces the existing contractors off site and the business faces an urgent requirement to up skill a new workforce.
- The emergence COVID-19 has now added another dimension as travel bans will mean a lot of the workforce will not be available on site
- Brexit arrangements have not been finalised and won't be for some time - adding to the uncertainty and risk for successful project delivery

What's the effect of all this?

- Although there are different methods being adopted the effects can be summarised:
 - Business and project specific skills and knowledge can be lost almost overnight
 - Projects face either stalling, lengthy and costly delays
 - A large up-skilling exercise is required adding further delays and costs
 - Contractors bring legal cases against the businesses and HMRC where compliance is questioned
 - Further scrutiny from HMRC possible where blanket bans have been imposed
 - Where the business is a Systems Integrator such steps can risk their ability to deliver projects for their customers



If it applies can IR35 be avoided?

NO

There is no way that IR35 can be circumvented by firms, other than to make the choice to hire all contractors on fixed term employment contracts - which basically means hiring them as if the IR35 applies, and paying over all the extra employment taxes.

This may have certain disadvantages:

- Increases admin for you with associated cost and resource pressures
- The contractors in question will want their rates increased to pay the for the shortfall - estimates range between 20 -30% increase
- Some contractors may find the imposition too arduous and leave their contract or return to permanent employment elsewhere

In short there is increased risk and cost in getting round the rules in terms of the projects and work packages you're delivering.



How can Liberas help?

The legislation only applies to companies above the defined threshold.

There's an exemption for end-clients who are 'small businesses' as defined by the Companies Act 2006 that means meeting two or more of the following criteria:

- Annual turnover is no more than £10.2 million
- Balance sheet total is no more than £5.1 million
- No more than 50 employees.

We fit into all the defined categories above. This allows us to provide support to organisations and SI's who may be challenged by the new rules.

The Liberas Managed Service Works Order

- It is important that any proposed solution ensures that compliance is still respected and achieved.
- Where a role is legitimately classed as within IR35 there should be no attempt to avoid or circumnavigate the assessment
- Our proposal ensures compliance, avoids potential legal challenges and ensures delivery to business is not adversely effected

The SOW - Part 1 of the process

- Assign Liberas Solutions as a single supplier providing a service
- The SOW defining this lists:
 - Deliverables
 - Milestone for delivery
 - Payment Schedule



- Liberas is liable to deliver to the terms of the SOW and if the deliverables are not met, then the client doesn't pay
- Liberas bills the customer according to the terms of the SOW
- The customer pays Liberas according to the terms of their contract with Liberas

Liberas / Contractor Agreement - Part 2 of the Process

- Liberas enters into an individual contract with each of the existing contractors on the client site
- They are transferred from their current arrangement onto one with Liberas
- The contractors bill Liberas for their completed time
- Liberas pay the contracts according to their terms of the contract

The proposal would be for all contingent workers to enter into contracted employment with Liberas - badging themselves as Liberas - with Liberas then entering into a deliverables-based managed service arrangement with the hiring company. This hiring company could either be an SI or an end customer.

The benefits of this are:

- It removes the need for the end user and/or SI to change and renegotiate a number of contingent workers' contracts.
- Reduces the risk for inflight projects in case it impacts existing resource levels.
- Ensure continuity of existing or proposed resource on a project.



- SI's could use this to themselves transfer all contingent workers for a client onto their works order(s). This could be an added offering and may allow contingent workers outside your current remit join.

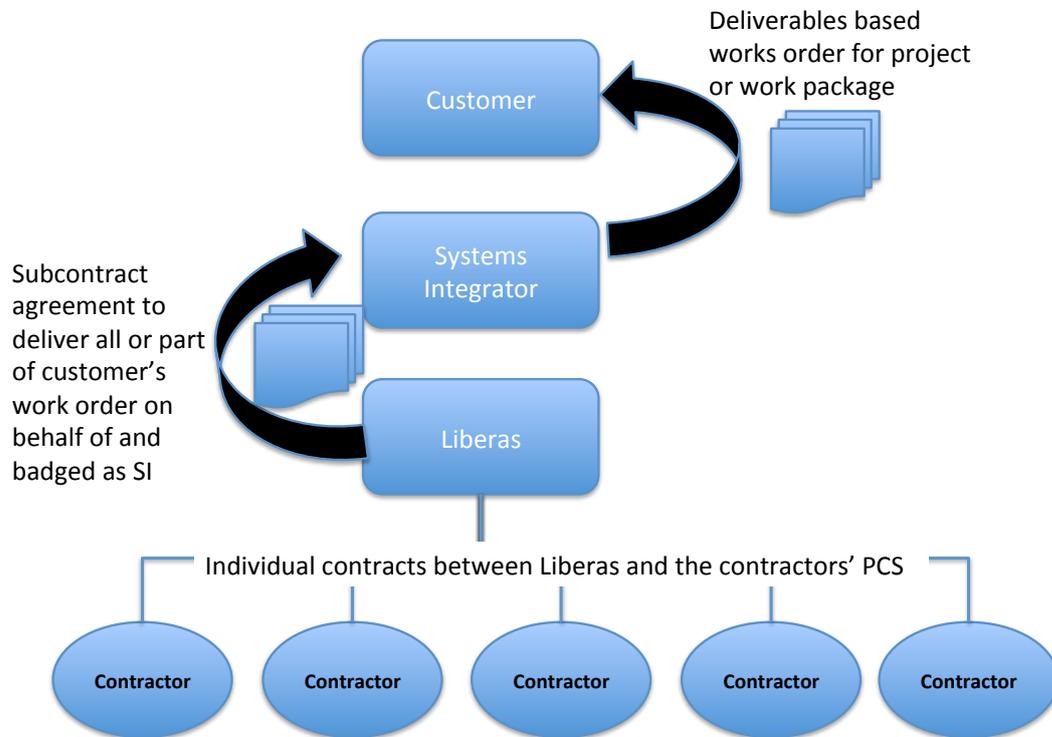
Managed Service - SI's

A managed service arrangement with Liberas would fall outside IR35.

Consider the following scenario:

A systems integrator has a number of projects to deliver. Obviously where they can they will fill those projects with permanent staff. In the instance where they either require specialist skills or the demand outstrips the supply of available employees they would then look to the contingent worker market.

To that currently they go through an agency and fill roles individually. Through our proposal they would come to Liberas and enter into a managed service arrangement where we will support the SI in delivering the project. It's up to Liberas how it fulfils that arrangement - in reality we will ensure a continuity of resource but according to the service agreement we decide who does the work and where they do it from.



Liberas is doing this already with another provide at a major UK mobile telecoms provider and this has helped them mitigate any impact to the on going IT projects.

As with all our commercial agreements we will adhere to any NDA and exclusivity requirements you have and will negotiate the margin we will take for each contractor based on volume and length of agreement.

If this proposal seems to make sense and add value or if you just need to discuss further around the impact of the legislation then please contact Mike at mike.mcilroy@liberas.co.uk or directly on mb: 07973640412.