

# THE REC IR35 GUIDE FOR CONTRACTORS



## Extension of the off-payroll rules into the private sector

**NOTE:** The REC has written this factsheet for REC members to share with contractors in preparation for the IR35 reforms due in April 2020. We have written it based on the draft legislation produced in July 2019 – we will update this document when the legislation has been finalised.

### WHAT IS HAPPENING AND WHEN?

**What:** The Government is extending the off-payroll rules, which have applied in the public sector since April 2017, into the private sector. The new rules will apply to work done by contractors working through intermediaries such as personal service companies. Importantly, the tests for IR35 status are not changing but the responsibilities for making the status decision and related deductions are.

**When:** The new rules will apply to all payments made to personal service companies on or after 6 April 2020.

**What's the difference?** From 6 April 2020, the client, and not the contractor, will be responsible for assessing IR35 status. For inside IR35 assignments, the fee-payer will have to make tax and national insurance deductions before paying the personal service company.

Contractors who work through intermediaries such as **personal services companies** should already be applying the IR35 rules. The intermediary should make an assessment on each assignment: if that intermediary did not exist, but you behave and are treated like an employee of the client, then for tax purposes the relevant assignment is deemed to be 'inside IR35', i.e. your pay should be subject to PAYE tax and national insurance. Employers' national insurance will also be due.

In April 2017 the Government introduced the off-payroll rules in the public sector. From 6 April 2020, these rules will also apply in the private sector, albeit with some changes. A client will need to know how you are engaged e.g. whether PAYE by an agency or whether paid via an intermediary. Importantly, the off-payroll rules will apply even where clients engage contractors directly, rather than through an agency (so working directly with a client will not avoid the changes). Also, if you work in the construction sector, please note that IR35 has always taken precedence over the Construction Industry Scheme and should be considered before engaging someone via CIS.

**The key issue is that the client, and not the contractor or their intermediary, will be responsible for assessing the contractor's status for tax purposes.**

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**Small companies exemption** – small companies will be exempt from the changes. A small company is one which meets two or more of the following criteria (a) annual turnover of not more than £10.2 million, (b) balance sheet total of not more than £5.1 million or (c) no more than 50 employees. Companies in groups and joint ventures will be exempt provided all of the group companies or joint venture partners are small. Unincorporated organisations with a turnover of less than £10.2 million will also be exempt. Where organisations are exempt, the existing IR35 rules (where the intermediary is responsible for applying the rules) will continue to apply.

When an organisation becomes or ceases to be small in an accounting period, for the purposes of the off-payroll rules that change will apply from the start of the tax year following the end of that accounting period, irrespective of whether the organisation is incorporated or unincorporated. There will be anti-avoidance rules to prevent organisations restructuring so as to avoid the rules.

**From 6 April 2020 the off-payroll rules will apply to all public authorities, medium and large companies and organisations with a turnover of more than £10.2 million.**

**Making the tax status decision** – the client will have to understand the IR35 rules and use an appropriate assessment tool to reach an accurate status decision (called a status determination statement (SDS)). In 2017 the Government introduced the [Check employment status for tax \(CEST\)](#) which is an online tool. CEST has come in for significant criticism and the Government has been working to enhance the tool. HMRC have said that they will stand by CEST outcomes provided the information inputted is accurate. Importantly, CEST is not mandatory and clients can use any assessment method they wish – however at all times the client must use 'reasonable care' in making its tax status assessment. So, clients should not make blanket decisions such as 'all contractors are inside IR35' or 'all contractors are outside IR35'. If a client does not take reasonable care in making its decision it will be liable for unpaid tax and national insurance.

**Passing status decisions through the supply chain** – having made the tax status decision, the client will have to pass that decision, together with the reasons for its decision, to both the party they contract with (usually the recruitment business) and the contractor (even though the client does not have a contract with you). Each party has to pass the decision down until it reaches the fee-payer i.e. the party next to the intermediary in the supply chain.

**Resolving disagreements over status** – the end user client must set up a client-led status disagreement process to help resolve disagreements about the status decision reached. The client must respond within 45 days of receiving a query and must:

- (a) confirm that it has considered the representations made and decided that its SDS is correct, and give the reasons for that decision; or
- (b) give a new SDS containing a different conclusion and state that the previous SDS is withdrawn.

If the client does not respond within 45 days it will become the fee-payer.

Please note that REC advises its agency members not to substitute its own or a contractor's view on status where this conflicts with the client's decision. We also advise that simply adding an unrestricted substitution clause to a contract will not bring an engagement outside IR35 if the reality, weighing up all other circumstances, is that the engagement is inside IR35.

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**Deductions** – where the client assesses the assignment as 'inside IR35', the fee-payer will have to deduct tax and national insurance before paying the intermediary. If the fee-payer is offshore, its responsibilities move up the supply chain to the next UK based entity. If HMRC does not receive the appropriate deductions, liability will continue to move up the supply chain, and ultimately HMRC may pursue the client.

## What does this mean for contractors?

The Government published its [draft legislation](#) in July 2019 (which should be finalised by the end of 2019/early 2020) and [guidance](#) in August 2019. However **clients and agencies must start to prepare** for what is a fundamental change in tax rules.

### 1. To assess who may be affected, agencies and clients will:

- Have to ask questions about ownership and management of an intermediary. Specifically if working through a company they will need to know whether you own more than 5% of shares. If you work through a partnership they will need to know if you are entitled to 60% or more of the profits of the partnership. If you do own more than 5% of shares in the company or are entitled to more than 60% of the profits of a partnership, they must consider the off-payroll rules (assuming the client is not a small company and therefore exempt). If you do not own more than 5% of shares they will need to know that the company you work through (e.g. an umbrella company or a CIS intermediary) is already deducting tax and national insurance.
- If you do own more than 5% of shares or are entitled to more than 60% of the profits of a partnership, they will ask for UTR and VAT nos., and may enquire how many other clients you have and what insurances you hold. This is to establish that you are genuinely in business on your own account, which is what IR35 is all about.

**Agencies must comply with tax law and so will not be in breach of data protection law by asking for information relating to your ownership or management of a personal services company or partnership provided they process it correctly.**

### 2. The client must pass their SDS down the supply chain. Where a client decides that an assignment is inside IR35:

- The fee-payer will have to deduct tax and national insurance before they pay the personal services company (previously they would have paid gross). They will also have to pay employers' national insurance. They will pay these monies to HMRC and will report the deductions via Real Time Information. You will have to give an up-to-date tax code to the fee-payer, otherwise they may have to apply emergency tax to your pay. They will also need your national insurance no. (From 6 April 2020 agencies will also have to give a [key information document](#) to work-seekers. This document will set out the various deductions the agency will make to pay and is intended to improve pay transparency).
- Some clients may be prepared to increase pay rates to cover some of the deductions and to reduce the potential loss of pay, but others will not (they may argue that contractors should have been deducting tax and NICs all along). Some clients may also offer permanent roles to contractors. Some may refuse to allow contractors to work through personal service companies.

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- From a processing and accounting point of view it is quite complicated for agencies to payroll personal service companies. So if a client determines that a role is inside IR35 the agency may decide that it will only pay contractors via PAYE. Some agencies do not run their own payrolls so they may pay contractors through another organisation, such as an umbrella company. They must ensure that any umbrella company they work with are compliant in all matters and so may have a list of approved umbrella companies for you to choose from.

**3. If the client determines that a role is 'outside IR35' the personal services company remains responsible for its own tax affairs.**

## TOP TIP

Be wary of any organisation that says they can pay you 80% or 90% of pay "tax free" or who offer payment "solutions" such as loans or offshore arrangements. HMRC is very alert to disguised remuneration and is tackling this e.g. through the loan charge which came into effect on 6 April 2019. Beware also Schemes that claim to benefit from a QC opinion and claim they are not disclosable under the Disclosure of Tax Avoidance Schemes regime. See [HMRC's Spotlights](#) for schemes which HMRC considers not to be compliant with tax law.

Also be wary of contract reviewers who say they can "get you outside IR35" simply by adding an unrestricted substitution clause to your contract. Courts look at all of the circumstance of an engagement and not just the contractual documentation.

The 2020 changes are a fundamental change in how contractors will be treated for tax purposes. But being taxed as an employee does not mean that a contractor is an employee or a worker for employment rights purposes. The Government has said it will look at aligning tax and employment status but has not started this exercise yet.

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