



IR35: The rules now

A guide for clients

The Government has u-turned on IR35 reforms.

Late September into mid-October has been a turbulent time for the Government and a confusing time (at best) for taxpayers, after former chancellor Kwasi Kwarteng's fiscal statement.

On 17 October, the new chancellor, Jeremy Hunt, reversed around two thirds of the tax cuts in the fiscal statement, including complicated changes to the controversial off-payroll working rules known as IR35.

Background of IR35

IR35 rules first came into law via the Finance Act 2000, the idea being to clamp down on the growing use of one-man-band limited companies to provide professional services to clients, where the individual was still working in a manner akin to a traditional 'employee'.

In other words, the rules were designed to clamp down on self-employed workers who enjoyed the tax benefits afforded by a corporate structure, while benefiting from what was essentially 'employment'.

If a contract was 'inside' IR35, it meant the contractor was a 'disguised employee' and would have to pay the same income tax and NICs as an employee, even if they worked through a limited company. If the contract was 'outside' IR35 and the contractor worked through a company, corporation tax was payable instead.

Directors of limited companies benefited if their contracts were outside IR35, because they could pay themselves low salaries and top up their payment with dividends, which were (and still are) generally taxed at lower rates than employment income liable for income tax and National

Insurance. They therefore had an incentive to find their contracts to be outside of IR35 legislation.

Note how contracts, not the worker, were and are analysed on a case-by-case basis as to whether IR35 applied or not.

IR35 was controversial from the start, with what is now the Association of Independent Professionals and the Self-Employed (IPSE) seeking permission for a judicial review of IR35 in 2001, which they lost.

After efforts to help taxpayers understand the rules more easily during the coalition-Government era, the IR35 tax rules were reformed in the 2016 Budget, when businesses were given more responsibility for determining the tax status of their contractors.

The aim of the policy was to ensure contractors who are not genuinely self-employed pay the same income tax and NICs as employees, and that businesses could not avoid taxes by hiring self-employed workers in the place of regular employees.

It came into force for the public sector in 2017, and the private sector in 2021 after a one-year postponement due to Covid-19.

However, it only applies to medium and large companies, meaning contractors working for small end-clients have to work out their IR35 status themselves.

A small end-client will fall under two or more of these requirements:

- turnover of no more than £10.2 million
- balance sheet total of no more than £5.1 million
- no more than 50 employees

In a surprise move as part of the September 2022 mini-budget, then-Chancellor Kwasi Kwarteng announced a repeal to both the 2017 and 2021 IR35 reforms from 6 April 2023.

This repeal was then cancelled, however, by Jeremy Hunt after he succeeded Kwarteng as Chancellor.

At the time of writing, no further changes are due to happen to IR35, and the end clients of contractors will continue to be responsible for applying the rules.

Good or bad?

Many businesses and contractors alike will be unhappy to hear the IR35 reforms have been repealed.

Andy Chamberlain, director of policy at IPSE, said:

“[The] announcement will be a huge blow to thousands of self-employed contractors and the businesses they work with.

“The reforms to IR35 have created a nightmare for businesses seeking to engage talent on a flexible basis, while simultaneously forcing individuals out of business altogether.”

Research conducted by YouGov earlier this year on behalf of IPSE found the reforms damaged the ability of businesses to grow and hurt freelancers.

The research found that despite nearly half of UK businesses (49%) stating they could not achieve “the same outcomes without the use of contractors”, 28% had decreased their number of contracts since the reforms.

The survey of 501 businesses also found that IR35 reforms had “financial implications” for 42% of companies and added a significant administrative burden for 47% of businesses.

Meanwhile, the reforms hurt many contractors and freelancers, 35% of whom had closed their business since the changes.

Many contractors’ clients may have unfairly and incorrectly determined they were inside IR35 rules, as 20% of businesses made a blanket statement and decided all their contractors were within IR35.

Chamberlain said:

“We know that the Government is well aware of the problems caused by this damaging legislation – the previous Chancellor said so at the mini-budget and the Prime Minister made it clear during her leadership campaign.

However, some people and organisations, such as the Resolution Foundation, call pre-reform IR35 rules “regressive”, as analysis shows higher-paying workers were caught within IR35 from 2021 onwards.

“Higher earners moving into self-employment could increase the scale of the resulting tax avoidance,” the Resolution Foundation said in this analysis.

It added that IR35 reforms have increased tax receipts:

“Repealing this provision [would have brought] about a fall in tax revenue of £1.1 billion next fiscal year, and £2.0 billion a year by 2026-27, presumably because of abuse as contractors choose to self-declare their self-employed status (which comes with a significant tax advantage over employees).”

What you need to do

So, with the IR35 reforms here to stay, businesses remain the ones liable to identify the true tax status of their contracted workers. But how do you know whether they are inside IR35 or not?

IR35 is underpinned by employment legislation and case law, so tests of employment have evolved over the decades.

A tool called ‘check employment status for tax’ (CEST) provides HMRC’s view of a worker’s employment status based on the information provided.

Hirers, agencies and contractors themselves can all use the tool. It was published in March 2017 in conjunction with the reforms.

IR35 checklist

The following is a non-exhaustive IR35 compliance checklist of some of the factors that can indicate whether a contractor is inside or outside IR35.

A contractor might be inside IR35 if they:

- carry out all the work they are contracted to do personally
- work for their own limited company, but receive employment benefits, such as paid leave or sick pay
- are being paid on a time basis
- work for one client long-term
- are supplied with the equipment by a client and work at their premises.

They might be outside IR35 if:

- they have the right to delegate or substitute work contracted to another person and use that right in practice
- they are paid on a project basis rate or at a fixed rate
- they can decide how and when they work, and can send a substitute to do the job
- pay for all rejected work is corrected at their own cost
- they work with more than one client at one time or on short successive projects with a variety of clients.

Get in touch to talk about IR35

FOR GENERAL INFORMATION ONLY

Please note that this guide is not intended to give specific technical advice and it should not be construed as doing so. It is designed to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.

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