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IR35 AND OFF-PAYROLL WORKING TAX TIPS FOR CONTRACTORS

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Contents

| | | |
|--|--|-----------|
| About Sarah Bradford | | 5 |
| About This Guide | | 5 |
| 1 At A Glance | | 6 |
| 1.1 | Overview Of The IR35 Rules..... | 6 |
| 1.2 | Off-Payroll Working Rules..... | 8 |
| 2 Legislative Framework | | 8 |
| 3 HMRC Guidance | | 9 |
| 4 Why It Matters | | 9 |
| 5 Key Terms | | 11 |
| 5.1 | IR35 Terminology..... | 11 |
| 5.2 | Off-Payroll Working Terminology..... | 12 |
| 6 Notional Contract Of Service | | 13 |
| 7 Employed Or Self-Employed? | | 14 |
| 7.1 | Employee..... | 15 |
| 7.2 | Self-Employed..... | 16 |
| 8 Determining Status In Marginal Cases | | 17 |
| 8.1 | Nature Of The Client’s Business..... | 17 |
| 8.2 | Nature Of The Job..... | 18 |
| 8.3 | Contract..... | 18 |
| 8.4 | ‘In Business On Own Account’ Test..... | 20 |
| 8.4.1 | Right Of Control..... | 21 |
| 8.4.2 | Right Of Substitution..... | 23 |
| 8.4.3 | Mutuality Of Obligation..... | 24 |
| 8.4.4 | Provision Of Own Equipment..... | 25 |
| 8.4.5 | Financial Risk..... | 26 |
| 8.4.6 | Opportunity To Profit..... | 26 |
| 8.4.7 | Basis Of Payment..... | 26 |
| 8.4.8 | Length Of Engagement..... | 26 |
| 8.4.9 | ‘Part And Parcel’ Of The Organisation..... | 27 |
| 8.4.10 | Entitlement To Employee-Type Benefits..... | 27 |
| 8.4.11 | Right Of Termination..... | 27 |
| 8.4.12 | Personal Factors..... | 28 |
| 8.4.13 | Intention Of The Parties..... | 28 |
| 9 Check Employment Status for Tax Tool (CEST) | | 28 |
| 10 Contract Review Service | | 30 |

| | | |
|-----------|---|-----------|
| 11 | Employment Status Consultation..... | 32 |
| 12 | Avoiding The Risks..... | 33 |
| 13 | Outside IR35 And Off-Payroll Working – The Tax Implications..... | 35 |
| 14 | IR35 Applies – The Tax Implications..... | 37 |
| 15 | IR35: The Deemed Payment..... | 38 |
| 15.1 | Calculating The Deemed Payment | 39 |
| 16 | IR35: Deduction For Expenses | 42 |
| 17 | IR35: Reporting The Deemed Payment | 42 |
| 18 | IR35: HMRC Enquiries | 43 |
| 19 | Failsafe Contract | 45 |
| 20 | Travel Expenses And Intermediaries | 45 |
| 20.1 | Scope..... | 46 |
| 20.2 | Supervision, Direction And Control Test..... | 46 |
| 20.2.1 | Supervision | 46 |
| 20.2.2 | Direction | 47 |
| 20.2.3 | Control..... | 47 |
| 21 | The Off-Payroll Working Rules..... | 47 |
| 21.1 | End Clients Within the Off-Payroll Working Rules | 47 |
| 21.2 | Nature Of The Off-Payroll Working Rules..... | 48 |
| 21.3 | Responsibilities Of The End Client..... | 48 |
| 21.4 | Status Determination..... | 49 |
| 21.4.1 | Status Determination Statement | 49 |
| 21.4.2 | What To Do If The Worker Disagrees With The Determination | 50 |
| 21.5 | Determination Is That The Off-Payroll Working Rules Do Not Apply | 50 |
| 21.6 | Off-Payroll Working Rules Apply – Fee-Payer Responsibilities..... | 51 |
| 21.7 | The Chain Payment..... | 51 |
| 21.8 | Calculating The Deemed Payment | 52 |
| 21.9 | Accounting For Tax And National Insurance On The Deemed Payment | 53 |
| 21.10 | Report The Payment To HMRC..... | 53 |
| 22 | Impact Of The Off-Payroll Working Rules On The Worker | 54 |
| | And Finally... .. | 55 |

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About this Guide

Off-payroll working and IR35 is an area that creates a lot of discussion amongst tax advisers and taxpayers, and some confusion too. The rules are anti-avoidance measures which were initially introduced to level the playing field where a worker provides services to an end-client through an intermediary, such as personal service company, and the nature of the engagement is such that were the services provided directly to the end client, the worker would be an employee of the end client.

Since their introduction the original IR35 have been modified and extended and to a large extent replaced by the off-payroll working rules, which move the burden of determining whether the anti-avoidance rules apply, and complying with them if they do, from the contractor to the end client. The off-payroll working rules were introduced from 6 April 2017 where the end client is a public sector body. They are extended from 6 April 2021 so that they also apply where the end client is a medium or large private sector body.

In this special report, Sarah Bradford explains the nature of the IR35 rules and the off-payroll working rules, and explain when each apply. She also gives some useful pointers and tips to make sure contractors don't fall into the common IR35 traps.

The commentary that follows sets out the rules as they apply from 6 April 2021.

1

At A Glance

From 6 April 2021, the IR35 rules continue to apply where services are provided by an intermediary, such as a personal service company, to an end client which is a small private sector body in circumstances in which the worker would be an employee if they provided their services directly to the end client.

The off-payroll working rules were introduced from 6 April 2017. From that date they apply in place of the IR35 rules where a worker provides his or her services to a public sector body through an intermediary, such as a personal service company, in circumstances such that if the worker provided their services directly to the public sector body, the worker would be an employee of the public sector body. From 6 April 2021, the off-payroll working rules also apply where the end client is a medium or large private sector company and the worker provides his or her services to the end client through an intermediary such that if the services were provided directly to the end client, the relationship between the worker and the end client is one of employer and employee.

In this guide a distinction is drawn between the two sets of rules; the IR35 rules refer to the rules in ITEPA 2003, Pt. 2, Ch. 8 and the off-payroll working rules refer to the rules in ITEPA 2003, Pt. 2, Ch. 10.

The IR35 or off-payroll working rules may also be relevant where services are supplied via an employment intermediary or umbrella company and that company is not required to operate PAYE.

The IR35 and off-payroll working rules do not apply to managed service companies that fall within the special rules for managed services companies. An intermediary, which may also be a managed service company, needs to consider whether the managed service company rules apply before considering whether IR35/off-payroll working is in point. Consideration of the managed service company provisions is outside the scope of this guide.

1.1 Overview Of The IR35 Rules

The IR35 rules are anti-avoidance rules, which were introduced with effect from 6 April 2000 in respect of services performed on or after that date. The measures were introduced to target workers predominantly in the IT industry who resigned from their job on a Friday and started working in a self-employed capacity on the following Monday in essentially the same role. However, their application is not limited to the IT industry – the rules potentially apply to any worker who provides his or her services through a personal service company or another intermediary.

The rules continue to apply beyond 5 April 2021 where a worker provides his or her services through an intermediary, such as a personal service company, to an end client who is a small private sector organisation and, ignoring the intermediary, the worker would be an employee of the end client. From 6 April 2017 to 5 April 2021, the rules applied where the end client was any private sector organisation and services were provided through an intermediary such that, ignoring the intermediary, the relationship between the client and the worker would be one of employer and employee.

Prior to 6 April 2017, the rules applied whenever a worker provided services through a personal service company or other intermediary such that the worker would be an employee of the end client if they provided their services to that end client directly, regardless of the nature of the end client.

Under the IR35 rules, responsibility for determining whether the rules apply, and applying them if they do, falls on the worker's intermediary. The off-payroll working rules replaced the IR35 rules where the end client is a public sector body from 6 April 2017 and where the end client is a medium or large private sector organisation, from 6 April 2021. Under the off-payroll rules, responsibility for determining whether the rules apply, and applying them if they do, rests with the end client.

The name 'IR35' is taken from the number of the HMRC (then the Inland Revenue) press release in which the measures were announced. The rules are also referred to as the 'intermediaries' legislation'. It should be noted that while the terms IR35 and off-payroll working are frequently used interchangeably, a distinction is made in this guide between the two separate sets of rules.

The IR35 rules target the perceived loss of tax and National Insurance to the Exchequer that may arise where a worker provides his or her services to a client through an intermediary such as a personal service company and, in the absence of the intermediary, the worker would be an employee of the client. So, instead of the worker paying PAYE and Class 1 employee's National Insurance contributions, and the client paying employer's National Insurance, the client makes a gross payment to the personal service company. The worker then extracts profits from the personal service company, typically in the form of a small salary and dividends and paying little or no National Insurance (as no National Insurance is payable on dividends). However, it should be noted that the personal service company will be liable to pay Corporation Tax on its profits. The IR35 rules seek to claw back the tax and National Insurance that the Government considers to be lost as a result of providing services in this way.

The IR35 rules bite where, but for the existence of the intermediary, the worker would have been an employee of the end client and the engagement is not one which falls within the scope of the off-payroll working rules (see Section 1.2). This is determined by applying the usual employment status tests (discussed in Section 7 below).

Under the IR35 rules, the responsibility for deciding whether they apply falls on the worker's intermediary. Where they apply, the effect of the IR35 provisions is to try to replicate the tax and National Insurance position that would have arisen had the worker provided his or her services to the client directly as an employee. This is achieved by regarding the earnings of the intermediary as the income of the worker and calculating a deemed payment, which is treated as having been paid to the worker on 5 April at the end of the tax year. The worker must pay income tax and employee's Class 1 National Insurance on the deemed payment and the intermediary must pay employer's Class 1 National Insurance. Certain deductions are taken into account in calculating the deemed payment.

1.2 Off-Payroll Working Rules

The off-payroll working rules apply in place of the IR35 rules from 6 April 2017 where the end client is a public sector body and from 6 April 2021 where the end client is a medium or large private sector body. The rules were introduced to address poor compliance with the IR35 regime and the difficulty for HMRC in policing it due to the sheer numbers of workers who provide their services through a personal service company.

Like the IR35 rules, the off-payroll working rules are anti-avoidance rules which seek to recover the employment taxes and National Insurance that is lost where a worker provides his or her services to an end client via an intermediary, such as a personal service company, where the nature of the engagement is such that if the intermediary is ignored, the relationship between the worker and the end client is one of employee and employer. However, unlike the IR35 rules, the responsibility for determining whether the off-payroll working rules apply, and operating them if they do, falls on the end client rather than on the worker's personal service company.

The rules were reformed from 6 April 2017 where the end client is a public sector body. The reforms introduced the off-payroll working rules and moved the responsibility for determining whether the rules apply from the worker's intermediary to the public sector end client. Where the engagement is within the off-payroll working rules, the fee payer must deduct tax and National Insurance from payments made to the intermediary. These rules are discussed in Section 21.

These rules are extended from 6 April 2021 so that they also apply where the end client is a medium or large private sector body.

Potential Trap

All contractors operating through an intermediary, such as a personal service company, may fall within IR35 or the off-payroll working rules, depending on the nature of the end client to whom their services are supplied. It is essential to consider which set of rules are relevant and whether they apply. Ignoring them can be a costly mistake.

2

Legislative Framework

The intermediaries (IR35) legislation is found in the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003), Pt. 2, Ch. 8. From 6 April 2021, this legislation applies where the end client is a small private sector organisation. From 6 April 2017 to 5 April 2021, it also applied where the end client was a medium or large private sector organisation and prior to 6 April 2017, where the end client was a public sector body.

The National Insurance rules are set out in the Social Security Contributions (Intermediaries) Regulations 2000 (SI 2000/727).

The off-payroll working rules contained in ITEPA 2003, pt. 2 Ch. 10. They apply from 6 April 2017 where the end client is a public sector body and