

UNDERSTANDING IR35:

ENIs Essential Guide



WHO DOES IT APPLY TO?

Let's consider three categories:

- **Contractors, you can't avoid the effect of IR35 if working for several organisations, nor its impact if you're a sole trader.**
- **Small companies, you may be unaffected for now (other than finding it easier to compete for the best freelance staff as you don't have to put them on PAYE), but you should still know the rules if you plan to grow.**
- **Contractors currently on PAYE, paid by the hirer or a third party, you're the one group that doesn't need to worry as the government can be sure you are already paying the correct tax. So just chill! Everyone else, though, needs to absorb what follows.**



WHAT DOES IT MEAN?

It's a tax legislation designed to combat tax avoidance by workers supplying their services to clients as a contractor (Limited Company/Personal Service Company).

First implemented in 2000, it was put in place to ensure the employment status of the contractor, and check that the correct tax was being paid.

In 2017, the rules changed for the public sector. The onus to prove self-employed status shifted: it was no longer the responsibility of the contractor, but instead lay with the hirer.

On April 6th, 2021, the government hopes to apply the changed legislation to the private sector, believing it will increase tax revenue by £1.9bn a year. The wording of the Finance Bill was so ambiguous it had to be changed and put through Parliament again.

WHAT HAS CHANGED?

The big change is that, for a lot of private sector companies, the tax liability will be their responsibility should the correct tax not be paid by the contractors. This responsibility is deterring many from employing contractors.

If a company is 'small', however, the liability is still the contractor's. This means it will be easier for small firms to attract contract staff. A company is defined as small if it has any two of the following:



**TURNOVER OF £10M OR
LESS**



**£5M OR UNDER ON IT'S
BALANCE SHEET**



**50 EMPLOYEES
OR FEWER**

If a contractor is unsure whether a company is small, they can ask the hirer, who must respond within 45 days.

HOW TO DEMONSTRATE YOU ARE A CONTRACTOR – ‘OUTSIDE IR35’

To be a genuine contractor, you must pass all three criteria below:



RIGHTS OF SUBSTITUTION

Provide the hirer with evidence that you have someone else who can step in and do the work if you are unable to.



SUPERVISION AND CONTROL

The contractor is taking charge of the project, deciding on the correct approach and the work required, rather than completing a defined job as an employee would do.



MUTUALITY OF OBLIGATION

The hirer is not reliant on the contractor to do the project; they could subcontract it to another firm. In addition, the contractor is not reliant on the project: this is one of several providing income.

Even if working for a small company, a contractor should consider if they pass the criteria. The hirer won't be liable, but the contractor will, if the tax authorities question the status.

If the hirer is a larger company and agrees the role is 'Outside IR35' the contractor needs to:

- Provide evidence of insurance just in case the project goes wrong.
- Get written evidence from the hirer that the role is outside IR35 (SDS).
- Provide evidence of substitution.
- Get a different contract making it clear the three criteria to be a genuine contractor have been met.

INSIDE IR35?

If the role doesn't pass the three criteria, then the contractor falls 'Inside IR35' and their tax must be paid through PAYE. This can be done in three ways:



Working for the hirer on a zero hours contract (giving flexibility), on the hirer's payroll.



Go onto the payroll of a third-party recruitment consultancy.



Use the services of an umbrella company (for peace of mind, check if they are FCSA- accredited and have a professional passport).

If you feel you do pass the three criteria but your employer has put a blanket ban on contractors (common at the moment) and isn't allowing you to work 'Outside IR35', then ask for an Employment Statement Determination. This must state why the off payroll working rules apply to the worker and you can raise a dispute if you disagree.

WHAT DOES THE HIRER NEED TO DO?



The hirer or company employing contractors should consider all the following:

- **Provide evidence of size if you are medium sized and it isn't clear.**
- **Consider if the work falls inside or outside IR35. As part of this you should use the government's CEST tool.**
- **Be aware that contractors can challenge a decision not to employ outside IR35, asking for an employment statement determination.**
- **For support when employing contractors outside IR35, talk to recruiters. There are also specialist lawyers and insurance companies that will help.**
- **Consider using an SOW model, a service ENI is offering.**
- **If outside 'IR35', get the paperwork in order: evidence of insurance, evidence you investigated the legitimacy of the IR35 decision, including the use of CEST, provide written evidence the role is outside IR35, get evidence of substitution, alter contracts to reflect the new legislation.**

SOLE TRADERS

Can sole traders ignore the legislation? Well, yes... and no.

The IR35 legislation applies only to incorporated companies. However, the rules around designation of employment status – which are closely tied to IR35 – affect everyone who provides a service to a client including sole traders, so it's still important for contractors to pass the three criteria.

In addition, under the updated rules, the responsibility for designating the contractor's self-employed status as a sole trader rests with the company receiving the contractor's services. The hirer would be liable if an HMRC investigation found evidence that employment status had been designated incorrectly. So larger organisations are applying the same process whether you are a sole trader or a contractor using a limited company.

International

The legislation is to ensure that those paying tax in the UK pay the full amount. As a result, it doesn't matter where the hirer/company is based, the deciding factor is where the consultant pays tax. If, for example, the contractor lives and pays tax in France and is working for a UK company, then the rules don't apply. Post-Brexit, however, that individual will need a visa if they aren't a British national.

GET IN TOUCH

If you'd like any help with understanding IR35, recruitment advice, understanding different global markets and talent pools, salary and retention questions or anything else recruitment related then please get in touch.

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