

We report on the issues raised in our consultation workshops on IR35 changes in the private sector involving our experts and representatives from HMRC and the Association of Professional Staffing Companies (APSCo).

One of the workshops was attended principally by end-user clients and the other by recruitment businesses. The discussions focussed on HMRC's proposals in the consultation, but also covered other concerns and queries of attendees. Whilst we will not know the final picture until the draft legislation is produced during the summer, the debate raised a number of issues and concerns.

Compliance Burden

The increased compliance burden for end-user clients under the new rules is a key concern. HMRC acknowledged the additional burden, but is adamant that the end-user can best understand and interpret the nature of an engagement to make an IR35 determination. HMRC believes that the proposals strike the correct balance between ensuring compliance and the administrative burden.

IR35 Status Determination

This is obviously a critical component of the new regime (i.e. determining whether the individual would have been an employee for tax purposes had they engaged directly with the end-user client). The discussion considered several areas of particular concern, including:

- The difficulty of applying what is a complex, and often subjective, test. The recent cases show that even the Tax Tribunals have difficulty interpreting the test consistently. There are number of potentially relevant factors to which varying importance can be attributed depending upon the exact circumstances. It is not a simple check-box exercise.
- The reliability and accuracy of HMRC's online Check Employment Status for Tax (CEST) tool. Users can rely on CEST if the answers they provide are correct. Users may not necessarily have sufficient expertise to answer the questions correctly or have all of the relevant information. There is a risk of CEST over-simplifying matters in complex situations and a perception that it has an inbuilt bias (or prudence) for finding employment status.
- There will be many situations where there is no clear answer under CEST. HMRC's estimate is that it fails to provide an answer in 15% of cases, and these will inevitably be the more difficult situations where a client is most in need of assistance from the tool.
- Making a determination of employment status can only ever be a "snap shot" in time. Determinations will need to be reconsidered periodically and must be revisited in the event of any material change in circumstances.

APSCo's view is that the tool should be adapted so that entering the information into the tool can be done jointly where a number of parties are involved (e.g. in situations where some of the relevant information will be held by a recruitment agency). However, HMRC is keen that ultimate responsibility remains with the end-user. Query whether this proposal could work without other parties taking a share of the legal responsibility for making the determination (which it appears HMRC would not favour).

HMRC was clear that its position is that CEST is reliable and accurate and reflects its published views on employment status for tax purposes. Due to the importance HMRC ascribes to the tool, it will be prudent for end-users to try to work with it where possible to give a layer of protection against any challenge by HMRC under the new rules.

Tax Liability

The section in the consultation document about deciding which party is liable when something goes wrong is a controversial area. It is proposed that the tax liability could move back up the supply chain to the end-user client (or an agency) even though it had fully complied with the requirements of the new regime. For example, if the client makes a correct assessment of "inside IR35", but an agency paying the PSC does not account for the correct PAYE/Ni and becomes insolvent, HMRC could then recover the underpaid PAYE/Ni from the client.

HMRC agreed that there could be circumstances where this could happen, but emphasised that the purpose of the new rules was to ensure accuracy in tax compliance obligations and minimise avoidance arrangements. Part of that was to encourage businesses in the supply chain to introduce rigorous controls and procedures, for example, to be aware of and vet every entity in the supply chain. They suggested that HMRC's aim was not to seek tax from a client or agency who had applied such procedures and was not at fault, for example, where a reputable agency in the chain had unexpectedly become insolvent. However, they acknowledged the possibility that the legislation may still pass the PAYE/Ni liability to the client in this situation, who will then be reliant on the discretion of HMRC as to whether it decides to enforce the legislation in those particular circumstances (i.e. not a comfortable position for the client reliant on the goodwill of HMRC to choose not to collect tax that is legally due!). A concern is also that smaller intermediaries will be prejudiced, as clients will only trust larger recruitment agencies who are more able to provide assurances on their credit rating.

Under the current public sector rules, clients are not liable for giving an incorrect IR35 determination to another party in the chain if they took reasonable care in making the determination. HMRC is considering changing this to a position of strict liability. Whilst in some ways, this is a positive for recruitment agencies (under the public sector rules, they could fail to deduct PAYE/Ni in accordance with a client's determination and still potentially be liable for underpaid PAYE/Ni if the determination was wrong), a concern is that it will make end-users even more cautious in their determinations, meaning that any borderline cases will be determined as "inside IR35".

HMRC said it was also considering the possibility of applying a reasonable care test throughout so that any party in the chain is only liable where it has not taken reasonable care. However, although the final position will be determined by the government, HMRC's current preference seems to be for the strict liability position, as it believes this will be more effective in ensuring diligence in the process and avoids the difficulty of deciding what constitutes taking "reasonable care".

Minimising Disputes

The clear message to minimise the risk of disputes was to ensure the creation of robust internal processes and establish clear contractual arrangements and communication with counterparties in the supply chain. Since the primary obligations under the new rules (i.e. to establish IR35 status, to account for tax liabilities and to facilitate the flow of information) fall on the client and the person paying the personal service company, there is a clear incentive for these parties to work together to apply the new rules correctly.

The importance was also highlighted of ensuring the worker is informed of any IR35 determination as soon as possible and given the opportunity to challenge its assumptions and conclusions. However, feedback on the consultation's suggested requirement of a formal resolution process implemented by the client was negative. This would be an additional administrative burden for little practical benefit, as there will be few circumstances where a contractor will want to get into a protracted dispute with their potential client in advance of an engagement, and even fewer where the client will change their view on the IR35 status determination as a result. Ideally, a dispute resolution process would have an independent referee, but HMRC was clear that it will not act as referee in disputes, and it is difficult to see anyone else that would do so in a manner that is practical and cost efficient.

Accuracy of Historical Status

Concern was expressed over the possibility that HMRC might revisit the historic IR35 status of workers and open new enquiries (i.e. where an individual decided they were outside IR35 under the "old" rules, but the client decides they are inside IR35 from next April).

Whilst HMRC confirmed that the new regime did not include an amnesty for historical arrangements, its view was that the new rules are forward-looking from 2020 and it would not be engaging in a widespread campaign of opening new enquiries into historic cases. This repeats a statement that was made in last Autumn's Budget and, whilst it provides no cast-iron guarantees, the hope is that HMRC will apply it in practice.

Supplies of Services Rather Than Labour

A distinction can be drawn between a supply of services and a supply of labour. For example, a company supplying a new IT system which is only paid at the end of the work and is required to ensure that the system works will be providing services (even though a particular individual may do the work); whereas a company that provides an IT worker to cover for an employee on maternity leave will be providing labour. A supply of services is often provided under what is referred to as a "Statement of Work".

HMRC agreed that a genuine supply of services rather than labour falls outside IR35. However, the key word is "genuine". Simply badging a supply of labour as a "Statement of Work" or putting in place a contract that does not reflect what happens in practice will not be sufficient. There is significant concern that Statement of Work models will be marketed and used incorrectly in an attempt to avoid IR35.

Employment Status

The sessions emphasised that a determination of "inside IR35" applies for tax purposes only and does not create an employment for the purposes of employment law.

The Taylor Report recommended addressing the inconsistencies between tax and employment law in relation to employment status. There is, however, a lack of clarity on how to achieve that. As a result, there is still a risk that an inside IR35 determination will lead to confusion over the applicability of employment law and protections.

The panel discussed the importance to, and commercial justification for, certain workers to provide services through a personal service company. It is important to consider the pros and cons in any given circumstances, but workers choosing not to be an employee of a specific organisation would normally have a good reason for making that choice, and clients choosing to use contractors would also have a justification for doing so.

HMRC was refreshingly open in its views and gave some good indications of what might be expected when the draft legislation is released. However, we will only have some certainty once it has considered the responses to the consultation and released the draft legislation, so we will monitor further developments with interest.

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