

On 11 July 2019, the government published both the results of its latest consultation on IR35 and the draft legislation. So were there any surprises?

The short answer is no, not really. However, we now have a greater degree of certainty as to how the new rules will apply. Here are some key points:

Is It Definitely Happening?

Anyone who still had a lingering hope that the government might change its mind will be disappointed. IR35 in the private sector will be brought into line with IR35 in the public sector with effect from 6 April 2020. The changes will apply to any relevant payments made from that date, meaning that it will be relevant to pre-existing contracts as well as new ones. In other words, end-user clients will need to determine whether IR35 applies to any of their existing contractors as at 6 April 2020, as well as any new ones taken on after that date.

IR35 Status Determination

For any worker covered by the IR35 legislation (i.e. working via a personal services company (PSC) and providing personal services to the client), the end-user will need to decide whether they would have been an employee if engaged directly by the end-user. The end-user will then need to provide a "status determination statement" to both the party it contracts with (e.g. an agency or the PSC itself) **and** the individual worker. The statement must include the result of the determination and explain the reasons for that conclusion. End-users will need to consider carefully how they set out the reasons for their assessment in the statement, in a way that both satisfies the legislation and minimises the risk of disputes.

Each party in the chain will then need to pass on the determination until it reaches the person paying the PSC. A party who fails to pass on the assessment in this way will potentially be liable for any PAYE/NI due under IR35.

Disputes Process

The consultation proposed a "client-led status disagreement process" if the agency or PSC contractor disagrees with the determination. In practice, although the legislation uses this title, it falls short of what was envisaged in the consultation. The legislation just provides that if the person paying the PSC or the worker makes representations that the determination is incorrect, the end-user must consider its determination again in light of those representations and within 45 days either change it or give its reasons for deciding that its original determination was correct.

This is good news for end-users in that they do not have to implement a more involved "process" to deal with disputes. However, it is bad news for contractors/agencies who were hoping there would be a process that gave them a good chance of changing an end-user's mind (e.g. with HMRC or some other person acting as referee). It is to be hoped that the guidance will offer some help in terms of the degree of detail that the end-user must provide either in its initial determination or in its decision on any challenge to it.

Tax Liability

The most controversial part of the consultation document was the proposal that the tax liability could move back up the supply chain to the end-user client (or the first agency in the chain), 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, could HMRC then recover the underpaid PAYE/NI from the client?

It has been confirmed that this will broadly be the position in the legislation. HMRC wants to motivate 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. We are still awaiting some secondary legislation with the details, and there may be some exceptions where the end-user is completely "innocent" (e.g. "in cases of genuine business failure, where deliberate tax avoidance has not occurred"). Note the use of the word "avoidance" rather than "evasion". HMRC is effectively extending its reach into areas where companies acting entirely lawfully may not be seen as innocent enough to escape a tax liability that properly belonged to someone else.

Moreover, it sounds as though at least some of these exceptions will be in HMRC guidance rather than the legislation itself, which leaves concerns as to whether they will be binding or could be changed by HMRC. Relying on HMRC to comply with its guidance, rather than legislation, is not a comfortable place to be when there are recent cases in which HMRC argued that its own guidance was wrong! A concern will also remain that smaller intermediaries will be prejudiced as clients will only trust larger recruitment agencies that are more able to provide assurances on their credit rating.

Under the current public sector rules, end-users are not liable for giving an incorrect IR35 determination to another party in the chain if they took reasonable care in making that determination. There was a suggestion in the consultation that this "reasonable care" defence would be omitted, with agencies feeling particularly aggrieved that they could then comply with an outside IR35 determination not to deduct PAYE/NI and still be liable if it proves to be wrong (i.e. because the end-user took reasonable care even though it got it wrong). However, the defence for the end-user has been maintained. Therefore, it will be important for end-users contracting with agencies to have a robust determination process so that they can show that they have taken reasonable care, even if HMRC ultimately disagrees with a borderline assessment. HMRC intends to set out in guidance how an end-user can fulfil its obligation to take reasonable care.

Small End-user Exemption

As expected, private sector end-users who qualify as "small" will be exempted from the new rules (i.e. the PSC will continue to be responsible for operating IR35 as per the present rules). The test of "small" for a company will be if it satisfies two or more of the following: turnover of not more than £10.2 million, a balance sheet total of not more than £5.1 million and not more than 50 employees. However, for unincorporated businesses only the turnover test will apply. There are some details around taking into account connected persons when deciding whether a business is "small" and some notification requirements for small businesses.

Check Employment Status for Tax (CEST) Tool

Consistent with previous communications, the government is committed to improving the CEST tool and says that enhancements will be rolled out ahead of April 2020. The hope is that this happens sooner rather than later, as end-users are already using the CEST tool to audit their arrangements. It also calls into question what happens if the new and improved CEST tool gives a different answer. For example, will public sector end-users be required to re-test all of their ongoing contractors under the new tool in case it gives a different result?

Affected parties should press on with their preparations in the lead up to April 2020. Although the legislation published is stated to be a draft only, the likelihood of material changes to it from here is minimal.

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