



IR35: An informed approach

Understanding IR35 in the private sector

Table of contents:

1. Introduction

2. What is IR35?

3. What is going to change?

4. Small company exemptions

5. Preparing change

6. How do I determine employment status: Inside or outside of IR35?

7. Managed Service – Statement of Work (SoW)

8. Limited Company Vs Umbrella

9. Take home pay example

1. Introduction

The rules for the taxation of those providing services through a personal service company (“PSC”) introduced under the Finance Act 2000, commonly known as IR35, will be changing from April 2020.

Changes to how IR35 is applied in respect to the provision of off-payroll working in the Public Sector were made in 2017. The intention is to make ‘similar’ changes for the Private Sector from April 2020.

Westlakes Recruit is a leader in the provision of contingent labour to the UK Engineering & Construction sectors. As such, we understand the unique challenges this presents to our clients and contractors in the UK. This paper provides an understanding of how new responsibilities may impact your business in April 2020.

2. What is IR35?

IR35 was introduced with the intention of ensuring that where individuals are operating via a PSC, they were paying the correct levels of income tax and national insurance, relative to their employment status. The basis of the legislation is to assess the nature of the direct relationship between the end client and worker (effectively removing any intermediaries).

3. What is going to change?

From April 2020, the responsibility for confirming the IR35 status of an individual will move from the PSC to the end client. The end client will need to demonstrate that “reasonable care” has been taken when making the decision.

IR35 determination moves from PSC to end client

From April 2020, the responsibility for confirming the IR35 status of an individual will move from the PSC to the end client. In addition to this, the end client will need to demonstrate that “**reasonable care**” has been taken when making the decision, the tax liability can revert back to the fee payer or end client where an incorrect decision has been taken by the end client.

HMRC suggest that their CEST (Check Employment Status for Tax) tool to establish

the IR35 status for individual. However, independent reviews have highlighted that employment law specialists could offer a more thorough determination of employment status as opposed to the CEST.

It is also important to acknowledge that ***current methods of establishing employment status will not change***; it is just the ***responsibility for the determination moves from the PSC to the end client***.

4. Small company exemptions

What is the small company exemption?

When the Government confirmed the April 2020 private sector extension of the off-payroll rules in October 2018, the Budget documentation contained a notable exclusion for small companies.

Small organisations will be exempt, minimising administrative burdens for the vast majority of engagers, and HMRC will provide support and guidance to medium and large organisations ahead of implementation. Although there was initially some confusion over the definition of the term 'small', the Government has since confirmed that it will use the same criteria contained in the Companies Act 2006.

During a 12-month period, a business is deemed to be a 'small' company if it meets 2 or more of the following criteria:

- Turnover – not more than £10.2 million
- Balance sheet total – not more than 5.1 million
- Number of employees – no more than 50

Any contractors engaged by small companies will continue to operate the IR35 rules as they do currently – and the responsibility for determining their employment status will not pass to their clients.

Any contractors engaged by small companies will continue to operate the IR35 rules as they do currently – and the responsibility for determining their employment status will not pass to their clients.

5. Preparing for change

There is much that can be done in advance of the proposed changes which will come into effect in April 2020.

We have categorized our approach into three distinct segments:

1. Consult:

We are embarking on a consultation between PSC's and clients to determine the finer details of our entire contingent workforce, inclusive of an assessment of the work scope being delivered.

2. Collaborate:

There is much that can be done in advance of the changes in **April 2020** and enough time to deal with these, but, this will only happen successfully if the whole chain of supply, including the end client, adopt a collaborative approach.

On a case by case basis, we are assessing the contractual obligations and working practices of each case in relation to an IR35 determination.

Beyond this preliminary determination assessment, we are communicating with clients and PSC's, some of whom are performing mission critical scope in the Nuclear Sector, to review how the workforce is supplied, taking into consideration a Managed Service Provision.

3. Communicate

The early evaluation and communication of IR35 statuses, on a case by case basis, enables an informed approach to IR35.

The public sector adopted a cautious approach to IR35, with blanket inside IR35 determinations. This led to the loss of significant numbers of the contingent workforce in pursuit of other opportunities and increased costs to retain services.

The early consideration of those who could be deemed to fall within IR35 will help manage potential increased costs such as:

- Without changing existing contract/commercial terms, it will be unlawful to deduct Employers National Insurance Contributions (ENIC's) from payments made to PSC workers who are deemed to be inside IR35.
- ENIC's must be made directly by the fee payer (recruitment agency) and this burden will ultimately be passed onto client organisations.

6. How do I determine employment status: Inside or outside of IR35?

The below table sets out some of the considerations as to whether the individual may fall 'inside' or 'outside' of IR35. The example answers would point to a determination outside of IR35: -

Considerations	YES	NO
If you were unable to provide the services personally, would your company be able to send a substitute with equivalent skills, qualifications and experience?	Yes	
Have you ever actually provided a substitute?	Yes	
Do you carry out services from your own office?	Yes	
Does your company have to work to set hours stipulated in your contract?		No
Other than observing client specifications are you told how to do the work?		No
Do you need to seek permission to take time off?		No
Are you obliged to carry out tasks not covered under the scope of your contract?		No
Does your notice period exceed 30 days?		No
Does your company carry any business insurance? EL, PL, PI, etc	Yes	
Is your company financially liable to correct any faulty work?	Yes	
Were you ever a permanent employee of your end client?		No
Do you have any line management responsibilities over client staff – appraisals, disciplinary, etc?		No
Do you have an office holder position within the clients organization (director, chairman) with high level managerial responsibilities such as control over budgets?		No

7. Managed Service – Statement of Work (SoW)



Our statement of work approach provides a service including **analysis of the project requirements, definition of project scope and subsequent delivery and measurement.** You maintain full visibility, flexibility and control of a delivery strategy that is aligned to your business requirements, with a delivery mechanism that is outside of IR35.

This piece of consultancy aimed at clients and PSC's who rather than simply reviewing contractual terms pointing towards an outside IR35 determination, will genuinely operate and deliver specific packages of scope within the framework of a SoW and outside of IR35.

Analysis of requirements

We will collaborate during a series of planning sessions and design a process that is specific to your business requirements.

Definition of Project Scope

We will develop the statement of work around a detailed project scope, we will produce the necessary documentation to drive adherence to your contract terms, pricing and service levels.

Delivery

On receipt of your work order we will programme your project details into our CRM and through a managed service team will provide your resources whilst tracking

milestones, payments and deliverables. Our CRM reports will track progress and provide you with regular information and updates throughout the project lifecycle.

Included in our SOW:

- Project scope
- Technical review
- Dedicated project delivery team
- On-going management and administration
- On-going compliance management
- Service delivery management
- Regular progress reviews
- Invoice validation and approval process
- Consolidated invoicing
- Project on/off-boarding

The benefits of our SOW solution:

- Compliance and risk management
- Streamlined processes ensuring greater efficiency
- Invoice/milestone management
- Transparency of costing
- Contract performance measured
- Centralisation of administration
- Flexibility to meet business demands
- Bespoke management information

8. A Detailed Comparison: Limited Company Vs Umbrella

The below table demonstrates the comparisons between a limited company and umbrella arrangement. In summary, the Limited company approach is more tax efficient but the umbrella is much less administrative:

	Limited Company	Umbrella
Service Provider Costs	You pay a monthly fee to your accountant to manage your company's tax affairs.	You pay a weekly or monthly fee (margin) to the umbrella company.
Tax Efficiency	A tax-efficient way to contract.	Your salary is taxed via PAYE.
IR35	An in-scope determination would lead to most (but not all) of the tax benefits of being lost.	IR35 is irrelevant, as you are already taxed as an 'employee'.
Ease of Use	Monthly admin required to help compile accounts, some annual obligations as company director.	Very little admin.
Legal Duties	Directors have a number of statutory and financial duties.	No legal duties.
Set Up	Company formation can be completed in a few hours, accountancy set-up should be prompt, Westlakes Recruit can help facilitate this process with our partners. Registration for taxes (VAT, Corporation Tax) can take a few weeks.	Instant set-up and Westlakes Recruit can help facilitate this process with our partners.
Your Status	You are the director of your own company.	You are an employee of the umbrella company.
Tax Planning	Highly flexible.	Few tax planning opportunities are available.
Timesheets / Invoices	You invoice the agency for work done on behalf of your company.	You submit your timesheet to the umbrella. The umbrella invoices the agency.
Paying Taxes	You are responsible for ensuring your company and personal taxes are paid on time.	The umbrella company deducts taxes before you are paid.
VAT	Joining the Flat Rate VAT scheme can be profitable – including a discounted rate in the first year.	No admin required.
Insurance	Your company needs to pay for business insurances (e.g. Professional Indemnity)	Insurance cover is typically included in umbrella fee.
Expenses	Option to offset expenses against the company's tax bill.	More restrictive scope to reclaim expenses.
Banking	A business bank account must be opened.	Operates through personal bank account.
Self Assessment	All company directors must complete an annual tax return.	No need to complete a tax return unless you earn untaxed income in addition to your umbrella earnings.

9. Take home pay example

We have used the typical remuneration for a Senior Project Planner in the nuclear industry to demonstrate the difference in take home pay between limited company, umbrella and a staff position:

Clearly the limited company arrangement generates a greater take home pay, but, given the risks associated with the impending IR35 introduction, the umbrella route offers good economies in comparison to a permanent position.

	Limited Company (£)	Umbrella (£)	Permanent (£)
Income	88,000.00	88,000.00	60,000
Personal Tax Deductions	8,620.67	21,505.43	11,500
Corporation Tax	12,761.58	0.00	0.00
NIC's	533.78	8,678.72	5,164.16
Net Personal Income	58,283.97	50,015.84	43,335.84
Expenses	3,000.00	3,000.00	
Pension	3,600.00	3,600.00	
Annual Take Home Pay	64,883.97	56,615.84	43,335.84