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IR35 – WHERE ARE WE NOW?

Late September into mid-October has been a turbulent time for the Government and a confusing time (at best) for taxpayers and advisers alike, after former chancellor Kwasi Kwarteng's fiscal statement on 23 September. Indeed, not long after we wrote last month's article on the 'Mini-Budget' changes, on 17 October the new chancellor, Jeremy Hunt, reversed around two thirds of the tax cuts from the 'Mini-Budget', including complicated changes to the controversial off-payroll working rules known as 'IR35'.

Background of IR35

The IR35 rules first came into law via the Finance Act 2000, the idea being to clamp down on the growing use of 'one-man-band' limited companies to provide professional services to clients, where the individual (usually a director and shareholder) was still working in a manner like a traditional 'employee'. In other words, the rules were designed to clamp down on 'self-employed' workers who enjoyed the tax benefits afforded by a corporate structure, while benefitting from what may arguably have been akin to 'employment'.

If a contract was 'inside' IR35, it effectively meant the contractor was a 'disguised employee' for tax purposes and would have to pay the same income tax and NICs as an employee, even if they worked through their own limited company. If the contract was 'outside' IR35 and the contractor worked through their own company, the company would follow the usual rules on paying Corporation Tax on its profits and the director/shareholder would pay tax personally on any salary/dividends extracted from the company.

Directors/shareholders of limited companies benefitted if their contracts were outside IR35, because they could pay themselves relatively low salaries and top up their payment with dividends, which were (and still are) generally taxed at lower rates than employment income, which is liable to income tax and National Insurance. They therefore had an incentive to find their contracts to be outside of the IR35 legislation. Note how contracts, not the worker, were and are analysed on a case-by-case basis as to whether IR35 applied or not.

After efforts to help taxpayers understand the rules more easily during the coalition-Government era, the IR35 tax rules were reformed in the 2016 Budget, when businesses (the 'engagers') were given more responsibility for determining the tax status of their contractors. The aim of the policy was to ensure contractors who are not genuinely self-employed pay the same income tax and NICs as employees and that the businesses engaging the services of the contractor could not avoid taxes by hiring self-employed workers operating via their own limited company in the place of regular employees.

The new rules came into force for public sector engagers in 2017 and were expanded to private sector engagers in 2021, after a one-year postponement due to Covid-19. However, the rules only apply to medium and large companies/engagers, meaning contractors working for small end-clients have to work out their IR35 status themselves.

In a surprise move as part of the September 2022 Mini-Budget, then-Chancellor Kwasi Kwarteng announced a repeal to both the 2017 and 2021 IR35 reforms, due to take effect from 6 April 2023. This repeal was then cancelled, however, by Jeremy Hunt after he succeeded Mr Kwarteng as Chancellor.

At the time of writing, no further changes are due to happen to IR35 (subject to any new announcements in Jeremy Hunt's delayed fiscal statement, due to take place on 17 November), and the engagers/end-clients of contractors will continue to be responsible for applying the rules.

What you need to do

So, with the IR35 reforms here to stay, businesses remain the ones liable to identify the 'true' tax status of their contracted workers. But how do you know whether they are inside IR35 or not?

IR35 is underpinned by employment legislation and case law, so tests of employment have evolved over the decades. A tool called 'Check Employment Status for Tax' (CEST) provides HMRC's view of a worker's employment status based on the information provided. Engagers, agencies and contractors themselves can all use the tool. It was published in March 2017 in conjunction with the reforms.

The following list of points to consider may also be helpful as a non-exhaustive IR35 compliance checklist detailing some of the factors that can indicate whether a contractor is inside or outside IR35.

For example, a contractor might be inside IR35 if they:

- carry out all the work they are contracted to do personally;
- work for their own limited company, but receive employment benefits, such as paid leave or sick pay;
- are being paid on a time basis;
- work for one client on a long-term basis;
- are supplied with the equipment by a client and work at their premises.

They might be outside IR35 if, for example:

- they have the right to delegate or substitute work contracted to another person and use that right in practice;
- they are paid on a project basis rate or at a fixed rate;
- they can decide how and when they work;
- they take financial risk and all rejected work is corrected at their own cost;
- they work with more than one client at one time or on short successive projects with a variety of clients.

The above is for general guidance only and no action should be taken without obtaining specific advice.