

Analysis

IR35: far from a fallow year

Speed read

In the wake of the Covid-19 pandemic, the government postponed the introduction of reforms to the off-payroll working rules (IR35) from April 2020 to 6 April 2021. In the meantime, there's plenty for end-users to do to ensure a smooth transition to the new rules and avoid bear traps along the way. One of the key issues to consider is the extent of any corporate criminal offence (CCO) risk when businesses engage contractors recently assessed as deemed employed. End-users may commit a facilitation offence where they agree unrealistic contractual terms and/or where prevention procedures are inadequate. The challenges of IR35 can be avoided by hiring contractors as fixed term employees, or by engaging contractors as agency workers or as employees of umbrella companies; however, before contracting with any supplier of contingent labour, it is recommended that end-users carry out due diligence on suppliers' tax and regulatory compliance practices. End-users should not only review procedures for engaging contractors during 2020/21 and beyond, to avoid CCO, money laundering, and other regulatory risks, but they should protect against possible reputational damage through due diligence of pay practices and tax compliance in their supply chains.



Mark Groom
Deloitte

Mark Groom is an employment tax partner in Deloitte's reward practice. He advises

clients in all sectors on key employment tax related issues, including specialising in employment status, IR35, and pay benefits and expenses consulting and compliance.
Email: mgroom@deloitte.co.uk; tel: 020 7007 2770.

Whatever we all felt about it at the time, I think it's fair to say that given the disruption caused by Covid-19, we can now all see the wisdom in Chief Secretary to the Treasury Steve Barclay's announcement on 17 March which delayed the changes to off-payroll working in the private sector until April 2021. However, 2020/21 is far from fallow as regards IR35.

This article focuses on key issues to be addressed during 2020/21, as well as providing a summary of practical pointers to enable a smooth transition in April 2021. The proposed new IR35 rules have been covered in many other articles and are assumed knowledge for the purposes of this discussion.

Don't let the elephant in the room go rogue

I'll begin by addressing one of the questions I'm currently most frequently asked: 'What risks do we (as a private sector organisation) now face if we engage a contractor we previously assessed to be "deemed employed"?'

This is not a straightforward matter, and a grounding in the Criminal Finances Act (CFA) 2017, and the Proceeds of Crime Act (POCA) 2002 is needed to allay or confirm fears. Applied in an IR35 context, it is imperative that end-users have effective oversight of their contingent worker engagement processes to ensure they do not fall foul of these provisions.

CFA 2017

Starting with the CFA 2017, under s 45(1) of that Act, a relevant body (being a body corporate or partnership) is guilty of an offence if an associated person (an employee, agent or any person providing services for or on behalf of the relevant body) commits a UK tax evasion facilitation offence, and the relevant body does not have reasonable prevention procedures in place.

Section 45(5) defines a UK tax evasion facilitation offence as consisting of:

- being knowingly concerned in, or in taking steps with a view to, the fraudulent evasion of a tax by another person;
- aiding, abetting, counselling or procuring the commission of a UK tax evasion offence; or
- being involved in and part in the commission of an offence consisting of being knowingly concerned in, or in taking steps with a view to, the fraudulent evasion of a tax.

Importantly, the corporate criminal offence (CCO) is concerned with the criminal act of tax evasion. In contrast, determining the nature of services provided by contractors and, in particular, employment status, is complex and subjective, and it is easy for mistakes to be made.

The examples below give three hypothetical contractor scenarios and illustrate some of the possible challenges.

Examples

An end-user needs to re-hire three different contractors to complete an important project. In March 2020, the end-user issued status determination statements (SDS) pursuant to (draft) ITEPA 2003 s 61N(5), advising all three contractors they would be deemed employed from April 2020.

Contractor 1: The contractor considers that he is an expert and not under day to day control to any significant extent. He appealed his SDS pursuant to (draft) ITEPA 2003 s 61T, but the appeal process was never completed due to the deferral of the IR35 rule changes. The contractor intends to maintain his view of his self-employed status for 2020/21.

All one can really say in these circumstances is that the contractor will not adopt the end-user's view of their employment status. The contractor thinks he is right and the end-user is wrong, which is hardly criminal. Furthermore, the simple act of re-hiring the contractor does not facilitate one status or the other. Absent any other relevant factors, it is hard to see how any CCO risk arises for the end-user.

Contractor 2: This situation is similar to contractor 1's, but with an additional step: in March 2020, to secure the contractor's ongoing services, the end-user agreed an increase in day rate and a gross up of travel expenses, both intended to compensate for additional tax/NICs that would arise as a deemed employee from April 2020. However, following the announcement to defer IR35, the end-user agreed with contractor 2 that the original payment terms would be reinstated.

On the face of it, agreeing to revert to the previous payment terms might indicate that the contractor intends to commit a UK tax evasion offence, and the end-user's involvement might indicate that the end-user took steps with a view to that outcome.

However, much will depend on the precise nature of the negotiations with the contractor. If the end-user

reminds the contractor of its view of the contractor's employment status and tells them it is reverting to the original payment terms whatever status the contractor agrees with HMRC, it is hard to see that its actions are made with a view to the fraudulent evasion of tax by another person.

Contractor 3: This situation is similar to contractor 2's, except that contractor 3 will only work under a new contract that includes an unfettered substitution clause to ensure (he believes) that he remains outside IR35. The end-user needs the work done urgently and so accedes to this request, but the end-user insists that it will assess how well the job will be done before accepting any substitute(s). The end-user does not have any second level review procedure over this decision.

On the face of it, the contractor may intend to commit a UK tax evasion offence, but that won't be clear until he submits his tax return after the tax year.

By agreeing unrealistic contract terms, the end-user may have committed a facilitation offence, and its prevention procedures seem inadequate, so a CCO may have been committed.

By agreeing unrealistic contract terms, an end-user may have committed a facilitation offence

It should also be remembered that HMRC's amnesty on contractors' IR35 status in prior years only applies if HMRC has no reason to suspect fraud or criminal behaviour.

POCA 2002

Turning to POCA 2002, Part 7 of that Act provides for various money laundering offences. In short, a person commits a primary offence if he or she:

- conceals, disguises, converts or transfers criminal property or removes it from England and Wales or Scotland or Northern Ireland;
- enters in to or becomes concerned in an arrangement which he or she knows or suspects facilitates the acquisition, retention, use or control of criminal property;
- acquires, uses or has possession of criminal property, being any benefit (monetary or otherwise) from criminal activity.

Certain other offences – for example, 'failure to report' and 'tipping off' – apply to persons in the regulated sector (broadly speaking, businesses which are regulated by the Financial Services Authority (FSA) and also lawyers, accountants, estate agents and certain cash handling businesses). The 'failure to report' offence occurs when a person working in the regulated sector knows or suspects or has reasonable grounds for knowing or suspecting that another person is engaged in money laundering but fails to disclose this to a relevant officer.

Therefore, businesses in the regulated sector, and lawyers and accountants advising businesses in all sectors, will need to consider whether there are grounds for suspecting that contractors 2 or 3 might be engaged in money laundering. This doesn't seem likely in the case of contractor 1.

Other rules and regulations may also need to be considered, such as the code of practice on taxation for

banks. With all this in mind, it is perhaps no wonder that many end-users are refusing to engage with contractors through intermediaries with effect from April 2020, rather than waiting a further year.

Other engagement models

The challenges of IR35 can be avoided by hiring contractors as fixed term employees, or by engaging them as agency workers or as employees of umbrella companies (UC) (in either case, with no personal service companies in the chain). Some businesses have insisted this will be the only way they engage contingent labour from April 2021, while others have imposed this restriction early, from April 2020.

Agency workers are subject to PAYE/NICs if it cannot be shown that they are not subject to supervision, direction or control by any person, over the manner in which they provide their services. In that case, any reimbursed travel expenses to their normal client workplace is also taxable, since this is treated as ordinary commuting under ITEPA 2003 s 339A, which is also the case for UC employees. Other costs that will need to be considered include the fees/margin charged by the agency/UC, employer NICs, apprenticeship levy, auto-enrolment pension contributions, and VAT (where irrecoverable).

A non-tax point to check with UCs and agencies is the operation of the agency worker regulations, which apply in both cases. Another would be compliance with national minimum wage and auto-enrolment legislation. A third point to check would now also include their understanding of furloughing under the job retention scheme, particularly as no fees can be deducted from furlough grants.

I recommend end-users ensure they have a good understanding of all the above costs and are satisfied their suppliers are applying all these rules correctly through appropriate due-diligence at the outset and by conducting regular audits thereafter.

Contracted out services and statements of work

Draft ITEPA 2003 s 61M(1) applies the new IR35 rules to clients where a worker personally performs, or is under an obligation personally to perform, services for the client. The proposed new rules do not apply to clients where a client procures a contracted-out service from a services provider. The rules will apply to private sector suppliers providing such services if they are medium or large.

Consequently, in the run up to April 2020, many contractors sought to re-badge their services as contracted-out services under 'statements of work' (SoWs). Some contractors grouped to form a new 'consultancy' which, they argued fell outside IR35 because: (a) it did not provide personal service as it did not name the consultants being provided; and (b) it was small and the new rules only apply to medium/large businesses.

It is possible for contractors to provide a contracted-out service, but they will not do so by simply calling a contract a SoW and/or not naming contractors. The true nature of the services will be determined by other factors, including who has control over the contractor(s) and who bears most or all of the risks and rewards of the services provided. The position may be further informed by: a clearly defined deliverable rather than a description of

activities; a fixed price, rather than time and materials; and the number of contractors involved.

It is highly likely that end-users who get this wrong, and buy what they are led to believe is a contracted-out service but which is really a personal service, will be liable in full for any PAYE and NICs due; this could amount to over 50% or more of the fees paid for those services. Between now and April 2021, I can imagine a significant increase in contractors offering contracted-out services; it is important that end-users ensure they are adept at spotting the duds.

Summary

To avoid the difficulties highlighted above and to ensure a smooth transition to the new IR35 rules in April 2021 without too many last-minute compromises, I recommend that end-users take the following steps:

- Fully understand the new IR35 rules, including any amendments that come through in the final legislation.
- Review procedures for engaging contractors during 2020/21 and beyond, to avoid CCO, money laundering, and other regulatory risks.
- Protect against possible reputational damage through due diligence of pay practices and tax compliance in their supply chain.
- Document the strategic and operational positions taken to date, so that these can be easily leveraged with minimal reinvention.
- Catalogue the employment status assessments and SDSs already prepared for different roles and

individuals, and complete any still outstanding. Obviously, end-users will need to reassess this for contracts extant at April 2021.

- If end-users use a status determination tool, such as HMRC's CEST tool, consider developing a set of tie-breaker questions to help resolve cases for which the tool could not provide a definitive answer.
- Summarise the areas that should be re-tested before April 2021; for example, check contracts with suppliers and clients adequately reflect the final legislation; if an internal PSC payroll has been set up, make sure it will still interface with the accounts payable system; and ensure the communication programme with suppliers, contractors and clients is up to date.

Finally, at the risk of stating the obvious, I recommend that end-users conduct a de-brief with their various IR35 stakeholders to gain their collective views on how much time is needed for an orderly transition in April 2021. I suspect that Q4 of 2020 may not be too early to start again. ■

For related reading visit www.taxjournal.com

- ▶ News: Government delays IR35 changes and unveils rescue package for businesses hit by coronavirus (18.3.20)
- ▶ Off-payroll working in the private sector: preparing for April 2020 (David Smith & Richard Johnson, 21.10.19)
- ▶ Paint me a picture: employment or self-employment? (Stephen Pevsner, 14.1.20)
- ▶ Employment tax issues and the corporate criminal offences (Ian Hyde & Chris Thomas, 4.4.18)