

The Impact Of IR35 In The Private Sector: What Our Associates Said.



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Chapter 1

INTRODUCTION

1. Introduction

When changes to regulations happen, they often have consequences that impact companies, people, processes, or systems in a way that policy makers may not have intended.

1.1 Contractor Surveys

This whitepaper primarily looks at the knock-on impacts of the changes made in April 2021 to the off payroll working regulations known as IR35. The reference to contractors covers those that primarily provide services through their Personal Service Company (PSC) or Umbrella company,

Legislation was introduced in 2000 to tackle 'disguised employment', where an individual uses a limited company to carry out professional services but works in a manner more like an 'employee'. IR35 is a regulation that required workers (often referred to as contractors) to determine the employment status of any work undertaken and decide whether it was deemed employment. IR35 determines how an independent contractor should be taxed, its initial purpose was to stop individuals (not companies) from paying less income tax and National Insurance (NI).

The key change which came into effect in April 2021, is that private sector companies will now determine an individual's IR35 status, rather than the individual themselves. This brings the private sector in line

with the public sector, which went through the same change in 2017. Generally, an independent contractor classed as falling inside IR35 will have to pay taxes and NI contributions deducted through their payroll. However, this does not make them an employee. Additionally, they don't get any of the traditional benefits associated with employment such as holiday, sick pay, etc. but they take all the same financial risk and tax liability.

This whitepaper references results of two surveys undertaken with 100 of Simplify Consulting's Associate Network who have been engaged in providing services within the preceding two years. Survey one, referred to as "Pre IR35 Changes" was completed before the changes came into effect (Feb 2021) and survey two "Post IR35 Changes" was completed 6 months after the change (Oct 2021).

We look at the negative and positive impacts of IR35 and Matt Short Business Manager at Simplify Consulting shares his views on what can be done to improve the situation.

Chapter 2

CONSEQUENCES OF IR35

2. Consequences of IR35

2.1 Impact of changes to companies leading onto impact to contractors

It's no great surprise that businesses (end clients) displayed their nervousness about this shift in responsibility especially those who use contractors in large numbers. We recently saw HMRC win a case against former Sky Sports presenter⁽¹⁾ who has been ordered to pay £281,000 in missed taxes over a 5-year period. Where companies use high volume of contractors over several years the risk of incorrect status determination can be significant.

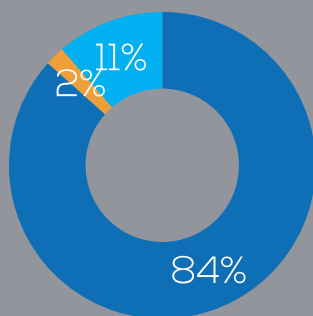
Pre April 2021 reform it was often straight forward for businesses and contractors to work together, with operating via a PSC being the norm, with our Associates working via this model in 84% of cases.

Now as many businesses are very cautious about the change in regulation, their responsibility and therefore risk - this often results in a different model being deployed. This has resulted in our Associates now only operating via a PSC in 41% of engagements, a reduction of over half.

It could be said that prior to the changes some contractors have been incorrectly applying the rules.

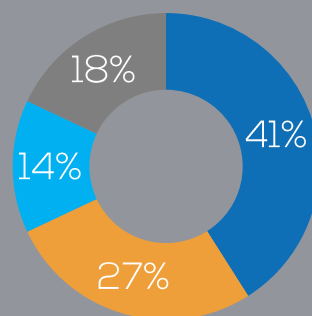
We asked our associate network what primary type of assignment they undertook both pre and post changes.

Pre April 2021 reform



- I work under my PSC
- I use an Umbrella Company
- I am in a permanent role
- I am on a FTC

Post April 2021 reform



At Simplify we now often engage contractors in a different way depending upon the work involved, client's requirements/preference and type of engagement either utilising our permanent team, a regulated umbrella company, a fixed term contract (FTC) or via a PSC.

Using consultancies is one solution that enable companies to attract highly skilled people, on a temporary basis rather than recruiting them permanently or forcing them through an umbrella or FTC.

For Simplify and no doubt other consultancies one of the big challenges in this new way of working is where clients more and more want to engage on a deliverables based commercial model i.e. if you deliver x, we will pay you y, yet contracted businesses are used to being paid a day rate, meaning consultancies take all the risk. It feels like a shift in the mindset is needed here where the models align all the way through the chain and importantly the risk is shared.

It's not just businesses that are having to adapt. Contractors wanting to maximise their opportunities are having to consider permanent roles, fixed term contracts and umbrella arrangements. There are pros and cons to all these options but the variation from one engagement to another makes it difficult to manage things such as pensions, insurances, and different types of contractual requirements.

Chapter 3

IMPACTS TO CONTRACTORS

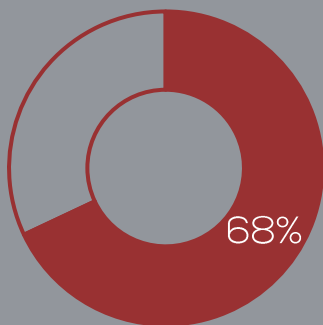
2. Consequences of IR35

3.1 Determinations and Assessments

It's reasonable to assume that the intention of HMRC was to try and ensure that contractors that are essentially operating as a disguised employee pay more (the correct) tax and NI. Most reasonable people won't argue with this, not even genuine contractors who have always operated correctly within the previous IR35 Regulations. However, the problem that this change has created is that the end clients have in many instances either put a blanket ban on using contractors, forced contractors to operate through umbrella companies or made blanket Status Determinations citing all roles as inside IR35.

3.2 Blanket Bans

Businesses are well within their rights to cease using contractors; however, it could affect their ability to operate effectively and efficiently if they can't bring in contractors where they genuinely have a short-term need for highly skilled individuals, which may not exist in the business or if they do, may not have the capacity to deal with work outside BAU. From the contractor side we have seen high volumes of contractors released by large businesses, many of the biggest banks were the first to act, releasing all contractors in advance of the regulatory change coming into effect.

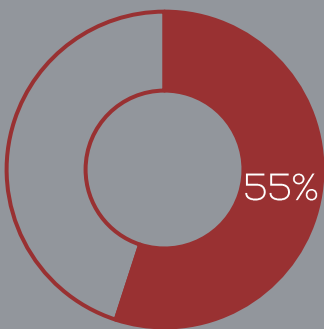


Said they have been impacted by blanket bans when working under their PSCs

Survey: Pre April 2021 reform

3.3 Forcing Contractors to work via an Umbrella

From the businesses perspective they are essentially removing the risk of IR35 as Tax and NI will be paid, whilst outsourcing payroll and therefore responsibility to umbrella companies. From the contractor side they are left to pay for the service provided by the umbrella company. They have no employment rights and may not be able to claim expenses. NI in some cases is passed on by the umbrella to the contractor through deduction in day rate and there are many umbrella companies out there that are unregulated. All in all, this is often a poor outcome for the contractor.

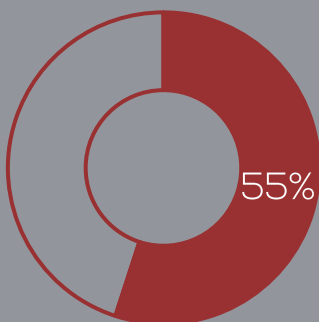


Of contractors have experienced blanket-umbrella company usage

Survey: Pre April 2021 reform

3.4 Blanket Status determination

This is where companies are determining their engagements are all inside IR35, without conducting an individual assessment. This could result in contractors paying more tax and NI if in fact the work could be 'outside IR35'. Whilst HMRC regulations prohibit this, it's clear that many companies are making blanket assessments according to our surveyed contractors. Whilst there is an appeal process, to date it has proved ineffective..



Said they have been impacted by blanket inside IR35 status determinations

Survey: Pre April 2021 reform



Many companies, (including the company I had a contract with) completed blanket assessments deeming every contractual arrangement to be inside IR35.

I could not work inside IR35 in the same role that had previously been outside IR35 (and which had been confirmed by independent assessment as outside IR35).

Survey: Post April 2021 reform

At Simplify we work on discrete engagements with defined end dates, it's change rather than Business as Usual (BAU) such as re-platforming, streamlining, product launches, Mergers & Acquisitions. We often utilise Associates for these engagements as they specialise in these disciplines and once the project is delivered their services are no longer required.

Many move onto another contract usually for other providers and often have to seek a new engagement. There can be gaps between engagements, which prevents receipt of benefits such as sick pay, holiday, or a pension. These are some of the reasons why contractors receive a higher day rate compared to their equivalent counterparts in permanent roles.

Whilst income may not be the main driver for everyone, and some people will say enjoyment of work, working environment, work/life balance or longevity are more important, a drop of 20% or 30% in take home will likely have a substantial financial impact, which is the reality of what's happened in the market for many contractors.

3.5 Income

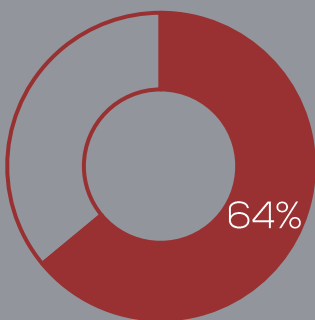
This reduction in income has mostly come about due to one or more of the following reasons:

- **Inside IR35** – Resulting in contractors paying NI and higher rates in tax compared with Corporation tax payable on outside IR35 roles.
- **Umbrella** – Umbrella companies charge a fee for their services, which is payable by the contractor.
- **Perm / FTC** – Tax and NI payable as a permanent employee will often be far higher than contractors pay in corporation tax for outside IR35 roles.
- **Taking longer to get a role** – Longer delays in finding work means contractors are spending more time unpaid, whilst trying to seek further work.



I am now inside IR35 and as a result my take home pay has fallen by about 20%.

Survey: Post April 2021 reform



Of contractors saw a reduction in income.

Survey: Post April 2021 reform

3.6 Choices

Many of our Associates have needed to take permanent, FTC or inside IR35 roles working via an Umbrella company, if it's a choice between that or not working, understandably many have opted to work and accept the different model and subsequent impact on pay.

It's not just about a loss of income, albeit for many that maybe the most immediate and obvious impact. Contractors often operate in this way for a reason, namely not wanting to get involved in corporate politics, 121's, line management responsibilities and other corporate requirements. Contracting allows a focus on delivery during a specified term and the freedom of choosing a wide variety of work across multiple organisations. Can forcing contractors down a narrow route with limited options be a good thing?

Chapter 4

SIMPLIFY COMMENTARY





Having worked closely with contractors for over three years many have expressed their frustrations with working in the perm space and do not wish to return to that way of working.

From the businesses perspective I see there being a risk that people who have contracted for many years won't want to buy into the corporate requirements and may not see the move as a long-term commitment.

4.1 What's the answer?

Firstly, I can't help but feel it would have made more sense to focus on making the rules clearer to follow rather than just shifting the responsibility of status determination from the contractor to the end client. Many feel the rules have always been very hard to follow with too many grey areas and this change has done nothing to address that issue. HMRC in many instances over the years have struggled to enforce the rules with courts often falling on the side of the defendant.

That said, we are where we are, just reverting to the old rules won't address the underlying issue, which is ensuring people pay the right level of tax for the work they are doing.



I'm not alone in feeling there needs to be further work to address the impacts now being seen in the market as a result of the changes.

Andy Chamberlain, Director of Policy at IPSE (the Association of Independent Professionals and the Self-Employed), said: *“Contractors are the most productive part of the crucial self-employed sector, which overall contributes more than £300bn to the UK economy every year. Not only that: they are absolutely vital for economic recovery, providing invaluable flexible skills to businesses getting back on their feet and adapting. But just when this sector is needed most, it has been hamstrung by the changes to IR35.”*

Chamberlain goes on to say *“the research shows the devastating impact the changes to IR35 have had on contractors, needlessly compounding the financial damage of the pandemic and the unnecessary gaps in support. Now, just when contractors are needed most – amid mounting labour shortages across the UK and particularly in haulage – government decisions have driven out a third of the sector.”*

A damning statement and one shared by many, you don't have to do too much research to see how people affected by IR35 both on the business and very clearly on the contractor side feel about it.



4.2 Areas I believe that could help the situation:

Improve the Check Employment Status for Tax (CEST) tool

Whilst this tool has been around for a while and HMRC say they will honour the decisions it provides; I think there is a nervousness around this, and many don't feel this is a robust tool to use.

Though HMRC continues to champion CEST, an 18-month investigation into the tool by ContractorCalculator has uncovered numerous shortcomings and inconsistencies, proving that CEST is not fit for purpose. These findings range from faulty processes and the omission of key employment status factors to an evident lack of testing during development.

Furthermore, whilst HMRC say they will uphold the decision CEST provides there is a caveat to say it's based on the right inputs. This is where it gets a bit tricky as several of the questions can be interpreted in different ways so you could argue that the input wasn't correct but that would be subjective. Like the rules themselves there are too many grey areas. Hence why so many businesses have chosen to just avoid Status Determination Statements (SDS) and instead utilise umbrella's, perm roles, FTC's etc.

If everyone is to have confidence in the rules and how they are applied, they need to be kept simple and clear, so if people fall foul of them, it's clear and obvious it was done deliberately and not due to a different interpretation.

Blanket decisions

HMRC made it clear that they wanted each role to be assessed individually so that the rules were applied where appropriate, however according to our analysis this is still happening. Perhaps clearer rules would prevent this but, in the meantime, there has to be a way to stop companies doing this as the impact to the contractor as we have seen can be significant.

Status determinations

Better education/support is needed to give companies and decision makers the confidence and knowledge to make more and better SDS's. Alternatively utilise 3rd party experts to ensure the SDS is accurate. They have the expertise, experience and understanding of case law to accurately and individually make SDS's on your behalf.



Chapter 5

OPPORTUNITIES FOR THE FUTURE

5. Opportunities for the future

It is not all doom and gloom, there are positives that have come about from the changes that were introduced.

5.1 The positives

- The main purpose of the change was to eradicate or at least reduce risk of people operating as disguised employees – the change would have achieved that albeit we know others have been inadvertently impacted.
- Consistency between private and public sector.
- Employees seeing what they may believe to be a fairer remuneration between contract and permanent staff for the same work.
- Employee benefits (pensions sick pay etc) and less paperwork and less stress or time to seek new work.
- It has opened up different types of opportunities that traditionally aren't contracted out.
- Contractors see their risk being removed and whilst they may reduce income in some circumstances there are no tax liabilities with HMRC.





Paid holiday/sick days through a PAYE umbrella contract, coupled with similar levels of take home pay when compared to limited company income following dividend tax changes and other changes aimed at penalising contractors, coupled with the lack of stress and paperwork around accounts and company/tax returns mean it is far simpler and stress free to work inside IR35.

Survey: Post April 2021 reform

The use of intermediaries or a Consultancy firm like Simplify creates new business opportunities which enable companies to compliantly use contractors and deliver change.

5.2 The opportunities

Contracts and working practices need to evolve to spread the risk associated with different ways of contracting such as fixed price rather than the more traditional day rate model.

Further clarity and transparency from HMRC of the rules and how they are applied will help both contractors and the end-client ensure compliance, and will no doubt reduce some of the knock-on impacts seen to date, subside.

With time and experience businesses will get better at assessing and determining the work correctly (increase their knowledge and expertise) or engage with 3rd party experts to ensure they are adhering to the legislation as it was intended.

Chapter 6

SUMMARY

6. Summary

Fundamentally the rules still need to allow genuine contract roles to be completed by contractors allowing them to correctly work via a PSC and focus on stopping those clearly in disguised roles being able to circumvent the rules.

The decision makers (HMRC) for this regulatory change in this instance must have known what the impacts would be as we saw the same thing when it was introduced in the public sector. It did settle down over time and this may be why HMRC chose to do it anyway. However, at a time where many are struggling because of Brexit and a Global pandemic the timing could scarcely have been worse and feels like a triple whammy for those in contract roles.

Our analysis clearly shows that companies are often not applying the rules correctly, making blanket decisions, which negatively impacts the contractor, potentially unfairly. Contractors feel they are being pushed into working with Umbrella companies, some of which we know

are unregulated, which is a poor outcome on many levels again for the contractor.

Contractors are waiting longer for work as there is less opportunity, earning less money due to Umbrella fees, potentially tax and NI, which may not be correct if the work hasn't been individually assessed as well as very few benefits received.

Whilst no doubt this change has reduced the risk of people operating incorrectly via a PSC, it has however also significantly and negatively impacted many others who may have been correctly working within the rules. It does feel like HMRC are punishing the masses for the sins of a few.

Time will give everyone the opportunity to gain a better understanding of the IR35 legislation and the practical application of the rules. Businesses will be more knowledgeable and able to assess and determine the work they require more accurately. Contractors will in time have more options of what they can take on and feel less forced into certain ways of working due to reduced opportunity.

If you are a contractor with Wealth and Transformation experience and would like to discuss joining our network, Simplify Consulting want to hear from you. If you are a wealth business wanting to deliver transformation, use practitioners in their domain but are struggling to deliver change following these changes then we would love to discuss how Simplify Consulting could help.

Simplify Consulting – It's what we do.



Chapter 7

THE TEAM

7. The Team

7.1 About the authors



Matt Short
Business Manager

Matt has held key leadership roles for over 17 years with a Global Bank Matt with a wealth of knowledge in Financial Services across many functions including Contact Centres, Operations, Projects and HR.

Leading the Business Management team he is responsible for managing all people and resourcing requirements, managing the Simplify Associate Network and supporting the business deliver their consultancy engagements

Prince 2 qualified Project Manager with key projects including a major global change programme, as the HR lead, responsible for assessing and managing all people and process impacts across both UK and Global Service Centres.



Giang Hughes
Business Support

Giang provides support for resourcing and helps manage the Associate Network, building relationships with suppliers and contractors.

A qualified coach Giang co-ordinates the Academy programme overseeing Junior Consultants as they progress to become consultants of the future.

With over 25 years experience working in learning and people development. Giang has successfully delivered skills programmes in adult learning, apprenticeships and developed professionals and leaders within Financial Services (insurance, wealth, retail and commercial banking).

End Notes:

(1) Austin, Amy (2021, November 08). *Former Sky Sports presenter handed £281k IR35 bill* FT Advisor: <https://www.ftadviser.com/companies/2021/11/08/former-sky-sports-presenter-handed-281k-ir35-bill/>

All Images – Henry & Co. Available at: <https://unsplash.com/@hngstrm> (Accessed 7 February 2022).