OFF-PAYROLL WORKING
UNDER AN UMBRELLA?

Kevin Barrow of Osborne Clarke LLP considers how businesses have adapted to cope with the changes to the IR35 off-payroll working regime that were made 12 months ago.

IR35, so called after the 1999 Inland Revenue press release which announced it, aims to suppress what HM Revenue & Customs (HMRC) has seen as a growth in false self-employment for tax purposes. This typically involves individual service providers being engaged through their own limited companies from which they pay themselves dividends, thereby taking employer National Insurance contributions (NICs) and some income tax costs out of the labour supply chain. These companies are usually known as personal service companies (PSCs) and the individual contract workers operating through them are often known as PSC contractors.

The original IR35 regime was introduced by Finance Act 2000. That regime is, in essence, what is set out in Chapter 8, Part 2 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) (Chapter 8). The regime has been expanded over the past few years with the off-payroll working rules introduced for the public sector from 6 April 2017, and for medium and large clients in the private sector, from 6 April 2021 (*Chapter 10, Part 2, ITEPA*) (Chapter 10). Unless otherwise specified, references in this article to the IR35 regime mean the IR35 regime that took effect in 2021 which is now set out in Chapters 8 and 10.

This article looks at how IR35 changed in 2021 and how organisations reacted to that change, what those organisations are doing now that HMRC's enforcement honeymoon period is ending, which parts of the regime cause most problems, and some of the major areas of risk for organisations.

BACKGROUND TO IR35

The original IR35 regime introduced in 2000 made a PSC liable for PAYE income tax and NICs if the individual contract worker operating through that PSC would have satisfied employment status tests had they contracted directly with the recipient of the relevant services, rather than contracting through a PSC.

The relevant employment status tests were, and remain, the multifaceted tests relating to control and personal service and other factors set out in case law such as *Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance* (*[1968] 2 QB 497*).

The problem for HMRC with the original version of IR35, which was in force from 2000 to 2017, was that most PSCs categorised themselves as being outside IR35. This left HMRC, where it disagreed with that self-assessment, to raise assessments and then bring proceedings against relevant PSCs on a case-by-case basis. Given the relatively

© 2022Thomson Reuters (Professional) UK Limited. This article first appeared in the May 2022 issue of PLC Magazine.

small sums usually involved, and the relative complexity of proving employment status, it was not economic for HMRC to pursue taxpayers, save perhaps in a small number of cases involving high-profile television presenters. Clearly, the government felt that something needed to change.

2017 changes

Legislation was introduced with effect from 6 April 2017 that changed the IR35 rules for situations where the end recipient of a PSC's services (end client) was in the public sector. Public sector was effectively defined to include all entities subject to the Freedom of Information Act 2000. This caught government departments, most universities and organisations such as the BBC, Transport for London, and Channel 4. These changes meant that the end client could, with others, become liable on the basis explained below for PAYE and NICs on payments made to that PSC.

If the end client engaged the PSC through an intermediary such as a staffing supplier (commonly called agencies), as will usually be the case, or a consultancy, then liability passed to that intermediary provided that the end client complied with each of the following administrative requirements:

- It issued, using reasonable care, its assessment (subsequently known as a status determination statement (SDS)) as to whether a particular contracting assignment does or does not satisfy the Chapter 10 condition triggering application of IR35.
- It responded, within 31 days, to any request (45 days with effect from April 2021) from the contract worker for an explanation for the assessment in the SDS.

The intermediary that paid the PSC, known as the fee payer, was primarily liable for any underpayment of PAYE income tax and NICs.

An assessment that the IR35 condition is satisfied (that is, effectively that employment status, determined in accordance with case law, applies) is commonly called an "inside IR35" assessment. "Outside IR35" is the term used where the condition is not satisfied.

The key point of the 2017 changes was that HMRC finally had an entity worth raising tax and NICs assessments, and subsequently litigating, against, whether that was the end client or the intermediary.

2021 changes

This 2017 off-payroll working regime was then rolled out to the private sector with effect from 6 April 2021 with some modifications that also applied to the public sector (*see box "Remains of the original regime"*). These included a provision that broadly makes the end client potentially liable if the fee payer fails to account to HMRC for the PAYE and NICs, regardless of the fact that the end client has issued an SDS that the supply is inside IR35. As HMRC drily observed in guidance: end clients should choose their suppliers with care.

There is a fraudulent document defence that moves liability away from the end client or fee payer where it can be shown that they were provided with fraudulent documentation that was designed effectively to deceive the recipient as to the true nature of the individual's engagement. However, it is generally considered unlikely that taxpayers will be able to use the defence except in very limited situations. In these IR35-related labour supply chain situations, the existence of that type of fraud will generally be hard to establish as a matter of law.

THE PUBLIC SECTOR EXPERIENCE

A recent survey of public sector user organisations by IFF Research on behalf of HMRC (IFF research) found that, at most sites where PSCs were used, there has been no change in use of PSCs and, if anything, there has been a slight increase (*www.gov.uk/government/publications/long-term-effects-of-the-off-payroll-working-rules-reform-for-public-sector-organisations*).

A sizable minority of public sector user organisations, 20% to 30%, said that it was harder to attract talent following the 2017 changes to IR35, but many contributors said that they felt that skill shortages were more of a factor than IR35 in terms of problems with attracting talent. The IFF research suggests that there were public sector plans to take PSCs onto payroll but in most cases that did not happen. Some respondents said they had planned to ban all PSC arrangements but had to change their plans because of skills shortages and the need not to alienate hard-to-find key talent.

30% of public sector organisations that responded said that contractor pay rates had gone up, as against 70% saying that they had stayed the same. It seems possible that the 30% with increased rates were the ones with more transferable skills.

88% of public sector organisations that responded said that they conduct individual IR35 status assessments. 30% said that they conduct role-based assessments. Only 1% said that they do blanket assessments which conclude that all PSCs, whatever their role, were inside IR35.

Awareness among end clients

Perhaps the most important finding of the IFF research was that 27% of public sector sites at which PSCs worked said that they had never heard of IR35, and 25% said that they had heard of it but did not know what it involved. This suggests that a large number of public sector organisations are not complying with the new IR35 regime. This, in turn, may partly explain the multi-million pound assessments suffered by government departments and agencies in recent months. Another factor behind the large assessments suffered by the public sector may have been reliance on the HMRC Check Employment Status for Tax (CEST) tool to assess the IR35 status of PSCs (*see "Reliability of CEST" below*).

There is likely to be a similar lack of awareness in parts of the private sector. For example, this could be the case where an end client is, perhaps unwittingly, using consultancies to supply consultants or other resources who are, in fact, engaged as PSC contractors. Where the supply is on a time and materials basis, with the end client broadly wanting a particular consultant, rather than paying a fixed fee for a defined deliverable without being particularly specific about who does the work, then the 2021 IR35 regime is very likely to apply and the end client will be primarily liable for PAYE and NICs relating to that PSC unless it has issued an SDS to the consultancy and PSC contractor.

There is a lot of evidence that major users of PSC contractors who are directly engaged or engaged through staffing suppliers have procedures in place to deal with IR35 risk, but this does not appear to be so much the case in relation to organisations that are heavy users of consultancy services.

PRIVATE SECTOR RESPONSE

In 2020 and early 2021, various predictions were made about how the rules would affect

© 2022 Thomson Reuters (Professional) UK Limited. This article first appeared in the May 2022 issue of PLC Magazine.

the use of individuals operating through PSCs by private sector organisations.

Many end client organisations adopted policies prohibiting the use of PSCs in their supply chains, requiring staffing suppliers to put contract workers onto their, or a third party's, PAYE payroll or taking individuals directly onto their own payroll. This led to suggestions that the affected individuals would insist on increased rates to compensate for the extra tax and NICs that would apply when they are put on a PAYE payroll.

Change to umbrella companies

Perhaps the biggest development was the move by many PSC contractors away from PSC models altogether into so-called "umbrella company" contracting under which, typically, an intermediary (the umbrella) acts as the employer of the contractor, whom it then on-supplies to end clients, often through staffing suppliers or consultancies (*see "Umbrella company arrangements" below*).

In some cases, this move was pushed by end clients, including some banks, following their prohibition of the use of PSCs. In others, it was pushed by staffing suppliers that did not want to have to set up payroll systems for PSCs on assignments that were assessed by end clients as being inside IR35. Due to the non-standard nature of putting a PSC on payroll and the relatively small numbers of contractors who wanted to continue to contract through their PSC on an inside IR35 basis, there do not appear to be many end clients, staffing suppliers or consultancies that pay PSC contractors on an inside IR35 basis, as opposed to putting them on a PAYE payroll as employees.

So, many affected PSC contractors switched over to umbrella arrangements and closed their PSCs. In some cases, the attraction of this move was linked to the willingness of some umbrellas to offer aggressive tax avoidance schemes in order to help the former PSC contractors to mitigate the financial impact of the 2021 IR35 changes.

Adoption of tailored status checking processes and SOW models

Other organisations adopted a more risk-based approach.

In some cases, this has involved use of the HMRC CEST tool, or their own or third-party checking tools sometimes supported by some sort of insurance, in order to assess whether an assignment would be inside IR35 or not.

Remains of the original regime

The original IR35 regime under which end clients and staffing companies have no liability remains in force only for arrangements that involve personal services companies whose services are on-supplied to an end client that is a small company or has no UK connection. A corporate end client is a small company if it falls within the Companies Act 2006 small companies regime (*section 60A, Income Tax (Earnings and Pensions) Act 2003*). That is, where at least two of the following conditions apply:

- Annual turnover of less than £10.2 million.
- Balance sheet total of less than £5.1 million.
- 50 employees or fewer.

Group turnover and that of any connected company or person are taken into account in determining whether the company falls within the threshold.

This would then lead to the engagement of a PSC if the tool concluded that the assignment was a genuine case of self-employment and so outside IR35. This often seemed to be the case if there was felt to be a right to send a substitute for the PSC contractor, apparently removing the personal service element from the relationship. In some cases, this approach was combined with a plan to move toward use of so-called statement of work (SOW) output-based contracts with PSCs under which PSCs were paid, to a significant extent, for delivery of a defined deliverable, rather than just for hours worked.

Risk management dilemma

The honeymoon period offered by HMRC relating to penalties for inaccuracies under the 2021 IR35 regime ended on 6 April 2022. Some indication of how HMRC will now approach enforcement is the fact that HMRC has already started flexing its muscles, with recent multi-million pound claims, including penalties and interest, against at least five government departments and government agencies for IR35 compliance failures (*see "Reliability of CEST" below*).

There are now appearing in government publications multiple references to the existence of tax fraud in the labour supply chain (*see "Umbrella company arrangements" below*). This seems to indicate that the government is planning to use the Criminal Finances Act 2017 (2017 Act) to attack some types of supply chain compliance failures (*see Briefing "Criminal Finances Act 2017: crime still doesn't pay", www.practicallaw.com/w-022-9657*). The 2017 Act would allow HMRC to target end client organisations whose labour supply chains are engaging in riskier structures, such as tax evasion, in order to be able to pay pre-2021 take-home rates for contractors at the pre-2021 cost to the end client organisation. Where those end client organisations do not have in place reasonable procedures to prevent tax evasion in their labour supply chains, they face the prospect of criminal prosecution and unlimited fines.

The dilemma for many organisations is that this is unfolding against a backdrop of well-documented skills shortages in many areas, which have made operational managers in many private sector organisations question the original risk-averse plans formulated by their legal and tax compliance departments in early 2021. Upholding low-risk IR35 policies has been challenging in markets where competitors seemingly ignore IR35 altogether and continue to pay PSCs gross with apparent disregard for IR35 status. Some stakeholders are asking if the risk of not having the required talent, or losing talent to less scrupulous competitors, may outweigh the risk of some IR35 liabilities. As a result, there is evidence that at some organisations the original compliance policies have been loosened.

The big questions being asked at many organisations now are:

- What is safe and not safe in terms of IR35 compliance policies in light of HMRC's developing thinking and recent enforcement activity?
- How far can original policies be relaxed in order to help to attract key talent at affordable, tax-efficient, charge rates?

© 2022Thomson Reuters (Professional) UK Limited. This article first appeared in the May 2022 issue of PLC Magazine.

- What will withstand due diligence if the organisation goes through a fundraising, merger or acquisition? In many recent deals, IR35 liabilities have been a major issue in negotiation and this, as much as anything, seems currently to be driving interest in IR35 compliance.

SOLUTIONS TO THE ISSUE

Private sector organisations have developed various solutions to the dilemma of how to access talent in a tax-efficient manner but still comply with IR35.

Umbrella company arrangements

It is very clear that in many areas in which PSC usage was common, one solution to the issues around IR35 has involved the use of umbrella companies. The government believes that umbrella worker numbers have risen from between 300,000 and 400,000 in 2014, to 600,000, if not more, in 2021 (*see box "Call for evidence"*).

The fact that the government labels some of the umbrella arrangements that have developed as tax fraud suggests that it may use powers under the 2017 Act to prosecute, and threaten with unlimited fines, organisations that do not have in place reasonable procedures to check that umbrella arrangements in their supply chain do not involve tax evasion.

There may be particular focus on those staffing companies and end clients that use, or turn a blind eye to, these arrangements in order to get a competitive advantage. Organisations whose workers are paid through an aggressive tax scheme in which tax and NICs are not properly accounted for can attract more workers and, in the case of staffing suppliers, supply them on at lower rates than law-abiding competitors, thereby increasing their market share.

In May 2021, HMRC published guidance regarding how organisations can conduct due diligence on their supply chains and it has started citing this guidance in recent investigations (2021 guidance) (*www.gov.uk/government/publications/use-of-labour-providers/advice-on-applying-supply-chain-due-diligence-principles-to-assure-your-labour-supply-chains*). Some end users and staffing suppliers have become aware that they are potentially liable for certain types of umbrella non-compliance and so are increasing their supply chain checks in line with the 2021 guidance and finding that some umbrellas are using unlawful arrangements. Some organisations have prohibited the use of umbrella arrangements in their supply chain.

But generally, in accordance with the IFF research about umbrella usage relating to the public sector, it is likely that most private sector organisations are not aware of the extent of umbrella arrangement usage in their supply chains. Anecdotal evidence in the public sector is that there has been a huge move of, for instance, medical professionals and care workers into umbrella models and it seems that public sector end clients are unaware of this. It is likely that the same has happened in the private sector.

Call for evidence

In light of the increase in the number of workers in umbrella arrangements, on 30 November 2021, the government issued a call for evidence about how umbrellas operate and what is bad and good about them (*www.gov.uk/government/consultations/call-for-evidence-umbrella-company-market*).

The document confirmed the government's commitment to bringing umbrella companies under the regulatory regime for staffing companies, which is enforceable through criminal sanctions. This regime is currently administered by the Employment Agencies Standards Inspectorate. The call for evidence document noted that accreditation by industry bodies, which many staffing companies have treated as all that is needed for due diligence purposes, is not a guarantee of compliance.

It is clear that something will be done. The call for evidence pointed out, in particular, that umbrellas are now the main conduit for the following:

- Disguised remuneration schemes using loans schemes. These seem to have declined in other areas of business but survive in some umbrellas.
- Mini umbrella companies (MUCs). The call for evidence repeatedly called these arrangements tax fraud and stated that MUCs are operated by organised criminals, involving National Insurance contributions (NICs) evasion and flat-rate VAT fraud. This risk has been publicised for some time by HM Revenue & Customs (HMRC) and the call for evidence refers to recent arrests of people involved in MUCs.
- Payroll fraud. This simply involves not paying over to HMRC the PAYE income tax and NICs that have been collected by the umbrella.
- VAT exemption and VAT concession misuse; for example, in medical staffing.

Benefits of umbrella arrangements

Notwithstanding the extra checks being carried out by many organisations, umbrella arrangements continue to be widespread, and of course many umbrellas are well-established organisations that are not involved in tax avoidance or tax evasion.

There has been a huge increase in non-employed or indirectly engaged (that is, not employed by the end client) ways of working in most major economies as organisations try to deal with fluctuations in demand and the increasing specialisation of many skilled workers. An increasing proportion of the workforce are not needed, or available, as permanent employees and that is feeding the rise of contract working. In light of this, it is arguable that the increase in lawful versions of umbrella-style suppliers worldwide, such as so-called professional employer organisations (PEOs) and employer of record companies in the USA and portage companies in France, is inevitable.

Matthew Taylor's July 2017 Good Work report on modern working practices (the Taylor report) identified that it might be helpful if an accredited body of intermediaries operated as employment intermediaries through which gig workers would provide their services and get paid each time they did some work (*see News brief "Report on the Taylor review: full steam ahead or running aground?", www.*

© 2022 Thomson Reuters (Professional) UK Limited. This article first appeared in the May 2022 issue of PLC Magazine.

practicallaw.com/w-009-3692). These intermediaries would administer tax, deal with training grants, run pension schemes, pay sick pay, and holiday pay for gig workers.

As countries around the world struggle with regulation of gig platforms, perhaps the government will see this as the right time for it to embrace umbrella companies, PEOs and employer of record models. With a prescriptive licensing regime in place, they can be used to ensure that gig and other non-employed or indirectly engaged workers get whatever employment rights the government thinks that they should have and, possibly more importantly, aid the collection of tax.

It seems likely there will be further regulation in the UK, possibly with a gangmaster-style regime that penalises staffing companies and end users that do not use licensed umbrella companies. This would mean that reputable staffing companies and end clients do not face unfair competition from less reputable ones that use non-compliant structures to undercut them on price, and can more easily work out which umbrellas are safe to deal with. It would also allow reputable umbrellas to invest in their businesses so that they can offer the worker support mechanisms that the Taylor report suggested were necessary if the gig economy is to work fairly.

Consultancy and output-based contracts

Consultancy arrangements that are charged for on a time and material basis are generally caught by the IR35 regime where the consultancy personnel operate through PSCs, as is common practice in many types of consultancy. There is a potentially very large exposure to the IR35 regime for end clients that use consultancy services as a result because, in many cases, the end-client will not have gone through the process of assessing the IR35 position and issuing SDSs. This means that the end clients of the consultancies are likely to be primarily liable under IR35 for any underpayment of PAYE and NICs relating to PSC contractors used by the consultancy.

Obviously, many types of personal services are supplied through output-based contracts involving the payment of a fixed price for a pre-defined deliverable, rather than a time-based charge. This structure effectively removes connotations of control and personal service from the relationship. As such, recipients of that type of service from an intermediary, such as a consultancy, will not be end clients with risk of tax liability under the IR35 regime. If the consultancy in turn engages the PSC on the basis of paying a fixed price for a pre-defined deliverable, rather than a time-based charge, that has a very high likelihood of falling outside IR35, and so the PSC can be paid by the consultancy without deduction of PAYE and NICs.

As a result, many PSC contractors have been moved into output-based contracting arrangements, often called statement of work (SOW) in the staffing industry and generally referred to by the government as "contracted out" work. This approach preserves the tax efficiencies of the pre-2021 IR35 position.

However, this is not as easy as a time-based charging arrangement; it requires scoping and drafting and monitoring of satisfaction of acceptance criteria. This can work, and is working in certain cases, but it is not a quick fix. There is anecdotal evidence that many arrangements have been set up to appear like output-based contracting arrangements but have then lapsed into hourly-charge arrangements as time has gone on or as contracts have been extended. The author considers that there is a potentially large IR35 exposure for users of these services and HMRC has announced that it is on the lookout for what it refers to as "false contracted-out" arrangements.

AREAS OF RISK

The solutions that the private sector has developed may work out differently in practice compared to how they were planned, involve certain problems, and cause organisations to face increased risks.

Reliability of CEST

Output-based consultancy arrangements will not work for every staffing supply, consultancy or contracting arrangement and, as a result, time-based consultancy will remain the norm for many situations. For this type of supply, it is essential to assess carefully whether the consultant is inside IR35. To assist this process, HMRC developed CEST, an online one-size-fits-all status assessment tool.

However, there are a number of problems with CEST. First, it gives a lot of "don't know" answers. Research suggests that this can be in 10% to 30% of cases, often in just those borderline situations where users most need help.

Secondly, even where a definitive answer is given, CEST has no statutory effect. HMRC has said that, in practice, it will not unpick an SDS where CEST has been used, provided that HMRC feels that the questions, many of which are subjective, have been answered correctly. In other words, HMRC feels that it can ignore CEST-based SDSs where it believes it is appropriate to do so.

In particular, many practitioners believe that the analysis in CEST overstates the weighting of substitution rights. This seems to have been at the heart of the unreliable CEST assessments that have informed many PSC contractors that they are outside IR35.

This sort of unreliable CEST assessment appears to have contributed to the recent Ministry of Justice problems with IR35 which resulted in a tax assessment of £72.1 million, including £4.5 million in interest and a suspended penalty of £15 million for the period 2017 to 2021. The Department for Work and Pensions (DWP) paid £87.9 million to HMRC after a review of its implementation of the off-payroll working rules revealed "historic" mistakes. The Home Office has received a £33.5 million bill, which included a £4 million suspended penalty, for its "careless" implementation of IR35 reform. The DWP and the Home Office both appear, like the Ministry of Justice, to have used CEST to determine whether a contractor fell within the scope of IR35.

As a result of this, many larger organisations have built their own tailored checking tools or are using ones provided by third parties but, sadly, this is also causing problems (*see below*).

Insurance and MSC liability

For those situations where primary liability passes to the end client, the end client may decide to cover this risk by requiring suppliers to indemnify them; however, indemnities from many types of supplier may not be of much use where the suppliers are involved in a relatively high number of (incorrectly determined) outside IR35 supplies across their whole client base, creating a huge level of potential indemnity liability. That is a problem because, with the exception of larger suppliers, most suppliers are unlikely to have the balance sheet strength to be able to pay all indemnity claims where large IR35-related assessments have been raised.

Many end clients and intermediaries have therefore outsourced their SDS checks to

© 2022Thomson Reuters (Professional) UK Limited. This article first appeared in the May 2022 issue of PLC Magazine.

third parties that carry out checks and, in many cases, offer insurance to cover any IR35 liabilities. Many third-party checking services seem to operate well but those that are associated with insurance arrangements may trigger managed service company (MSC) tax liability for end clients, intermediaries, PSCs and their officers (*Chapter 9, Part 2, ITEPA*).

The MSC regime is an anti-tax avoidance regime introduced with effect from 6 April 2007 which passes unpaid PAYE income tax and NICs liability on to anyone that has encouraged or been actively involved in the MSC arrangement. The provision of tax or NICs insurance by a MSC provider (that is, a person who carries on a business of promoting or facilitating the use of, among other things, PSCs) or by an associate of the MSC provider is a trigger for liability under the MSC regime. Crucially, the MSC regime applies only if the PSC contractor falls outside IR35, and so the use of IR35 insurance may turn out to be a dramatic own goal.

Another problem is that even if liability under the MSC regime is avoided, risk insurance for IR35 liability is new and, as yet, largely untested, so it is not clear when it would provide cover and when it would not. It also appears that some of the policies that cover IR35 risk have such sweeping exclusions that it would be easy for the insurer to decline to pay out in respect of what could be very large claims.

Even if there is no insurance or the insurance is made available in a way that does not create MSC risk, some third-party checking services seem to be associated with accountancy service providers or similar, that have a vested interest in a finding one way or the other. That is, they may have an interest in finding that a structure does trigger IR35 liability, as they can then attempt to cross-sell appropriate other services, such as umbrella company services, to the PSC contractor. Clearly this can create a conflict of interest and unreliable assessments. Others may have an interest in providing checking services which over-simplify the tests to get a high proportion of outside IR35 determinations and, for example, unreliably place too much weight on the absence of mutuality of obligation or existence of substitution rights when finding that a situation falls outside IR35.

Many third-party providers of IR35 assessment support will have good systems but clearly end clients need to take care. Above all, it is important to select advisers that have good systems for checking rather than just some impressive-looking insurance.

In light of the above, the key is for end clients to have proper checking processes in place, perhaps with help from a provider of independent checking services, and to understand why HMRC expects companies to check the compliance of their supply chains (*for example, see www.gov.uk/government/publications/use-of-labour-providers*).

Other risks

There is no such thing as a so-called "IR35 friendly contract", a term that is often bandied about by PSC contractors, that guarantees an outside IR35 status. IR35 applies based on the reality of the relationships rather than the specific wording of the contract. Having said that, where a PSC genuinely operates outside IR35, it is important to ensure that nothing in the contract gives the opposite impression. The author has seen a number of organisations continue to engage PSC contractors on terms which include clauses that provide for end client control, restrictions, continuing obligations and reference to regulations such as the Agency Workers Regulations 2010 (*SI 2010/93*), none of which would support a determination that the PSC contractor is genuinely self-employed and outside IR35. Given that the contract

Checklist for end clients

For those end client organisations that are not applying a blanket ban on the use of contractors working through personal service companies (PSC) and off-payroll working arrangements, some key actions are as follows:

- ✓ Identify all PSC contractors and off-payroll workers including those who are engaged through consultancies and online platforms. IR35 and umbrella risk can exist in a variety of supply arrangements and organisations need to apply IR35 protocols not just to obvious areas like staffing companies.
- ✓ Watch out for output-based consultancy arrangements that have rolled over and lapsed into supplies on a time-charging basis.
- ✓ Where PSCs are allowed to be paid outside IR35, make sure that the internal rules at the organisation are still being followed. There are signs of line managers becoming less scrupulous when reviewing contractor status than they were in April 2021.
- ✓ Do not over-rely on HM Revenue & Customs' Check Employment Status for Tax (CEST) tool, or rights of substitution, to justify an assessment that a contractor falls outside of the IR35 regime.
- ✓ Do not assume that once the IR35 assessment has been issued to suppliers that the matter is dealt with: liability can still fall on an end client organisation at a later date.
- ✓ Do not assume that insurance-backed checking services will be helpful or effective. Get advice on the managed service companies regime and make sure that the checks are effective (*see "Insurance and MSC liability" in the main text*).
- ✓ Conduct thorough checks on labour supply chains involving PSCs that are inside IR35 or umbrella companies. Undertake spot checks on random audit samples of contractors to make sure that credible amounts of PAYE income tax and National Insurance contributions are being paid.
- ✓ If there is a suspicion of compliance failures, make sure to use advisers whose advice is legally privileged in order to help resolve the problem. Just using forensic accountancy services may affect the organisation's ability to mount an effective defence if any claim is made.

© 2022 Thomson Reuters (Professional) UK Limited. This article first appeared in the May 2022 issue of PLC Magazine.

may be the first thing that HMRC looks at, it is important to ensure that it reflects the intended arrangement.

Contractor co-operatives, and in some cases, consultancies, have been established by some PSC contractors with the aim to disintermediate staffing companies and larger consultancies and at the same time avoid the IR35 regime. However, these will still be caught by IR35 for the most part if they involve time-based charging and personal services. In addition, they come with a serious risk of MSC tax liability for the PSC contractors and end clients.

In the construction industry, some suppliers are reverting to Construction Industry Scheme (CIS) arrangements in the mistaken belief that if tax is managed under the CIS regime, IR35 does not apply. This is not the case: IR35 applies to all supplies involving construction subcontractors working through PSCs, in the same way as it does for any other industry. It is only if a construction PSC contractor is outside IR35, and, hence, self-employed, that payments to the construction subcontractor PSC fall to be administered in accordance with the CIS.

Last but not least, some suppliers have reverted to allowing ex-PSC contractors to operate as sole traders. It is true that this takes the arrangement outside of the IR35 regime, but it does bring into play the arguably harsher tax regime for agency workers under Chapter 7 of Part 2 of ITEPA. While this is mainly an issue for the intermediaries rather than the end-client, end clients do need to check their contracts as these may contain inaccurate warranties about levels of supervision, direction or control.

Ability to appeal

PSC contractors who are unhappy with an end client's assessment that they are inside IR35 do not have a statutory right of appeal. Effectively all the IR35 regime gives them is a right, if they ask for it, to an explanation for the decision within 45 days of their request.

The IFF research into the impact of IR35 on public sector entities, where the right to an explanation has broadly been in place since 2017, suggests that, in any event, the volume of requests for an explanation have reduced, perhaps as a result of the fact that many requests that have been made have proved to be fruitless.

KEY ACTIONS TO MINIMISE RISK

Blanket banning of the use of all PSC contractors and other off-payroll working arrangements has been the strategy of some end client organisations, but current skills shortages appear to have caused many to relax those policies. It is certainly the case that in most other modern economies there is an increase in the use of flexible workforce arrangements and so blanket bans may be hard to maintain for some organisations without causing commercial damage.

There are, however, other steps short of a blanket ban that can be taken to minimise the risks and end client organisations would be well advised to look carefully at their arrangements given the likely increase in HMRC enforcement activity in the next year or so (*see box "Checklist for end clients"*).

Kevin Barrow is a partner at Osborne Clarke LLP.

Related information

This article is at practicallaw.com/w-035-2317

Other links from uk.practicallaw.com/

Topics

Atypical working	Topic/5-200-0618
Disputes and Investigations - Tax	Topic/2-376-3556
Employment income, pensions and benefits - Tax	Topic/4-376-4395
Employment status and self-employment	Topic/2-382-8831
National Insurance contributions	Topic/8-103-2100
Pay and benefits	Topic/0-200-0630
Taxation - employment	Topic/4-200-0628

Practice notes

Atypical workers: overview	8-374-3061
Employment agencies and employment businesses: regulatory aspects	3-200-2623
Employment contracts	9-558-0645
Employment status for tax	w-022-7907
IR35	9-201-7626
Managed service companies	6-225-4030
Workers' services provided through intermediaries: off-payroll working rules for private sector entities	w-028-8377
Workers' services provided through intermediaries: off-payroll working rules for public authorities	w-006-3549

Previous articles

The gig economy: shifting sands in employment status (2017)	2-639-5933
Harmonising employment practices: the challenges for multinational employers (2015)	6-616-3785
Employment policies and procedures: getting them right (2007)	5-367-3955

For subscription enquiries to Practical Law web materials please call +44 0345 600 9355

© 2022Thomson Reuters (Professional) UK Limited. This article first appeared in the May 2022 issue of PLC Magazine.