

Contractor Or Employee? Why Getting It Right Has Never Been So Important

In April 2020, new IR35 legislation will come into force in the UK – this will govern the misclassification of contractors as employees to prevent tax avoidance within private companies. The rulings have caused a huge deal of debate, with some calling it the death knell of independent working practices, and others praising the strong action against nefarious employers taking advantage of their workers and legislative loopholes.

IR35 changes also come at a time of increased scrutiny of corporations utilising the flexible working practices of the gig economy, hiring what they deem to be 'self-employed' contractors to fulfil the services of the business. As the landscape of contracting evolves, organisations have a lot to do to bring their processes in line with responsive legislation - but what exactly does IR35 mean, why is correct employee classification so important and how will the new rules affect organisations operating in the UK when they arrive next year?

What Is IR35?

The term IR35 describes tax legislation that aims to prevent the misclassification of employees as contractors for the purpose of tax avoidance by both the worker and the firm hiring them. Workers who are supplying services to companies via an intermediary (such as a limited company) can benefit from the flexibility of this arrangement, as well as paying lower tax and NI rates; companies hiring these contractors also benefit as they can avoid paying the employer costs and benefits applicable to employees.

The IR35 legislation deems whether these workers are in fact disguised employees with the same taxation obligations as a standard employee. Workers 'inside IR35' are defined as employees by the UK's tax authority HMRC and must pay the correct amount of tax - potentially leading to a 25% reduction in the worker's net pay. Those 'outside IR35' are considered to be legitimate contractors and can continue under the same arrangement.

IR35 became law as long ago as 2000 when the Intermediaries Legislation first came into force as part of the Finances Act. In the intervening years, HMRC struggled to enforce the legislation due to its complexity and uncertainty around employment status rules, so in 2017 the IR35 revisions were announced in the hope of greater clarity and more cases being successfully brought against those abusing the system. The initial set of reforms applied solely to the public sector, but in 2020 IR35 will also change for the private sector.

From 2020, private sector employers will now be responsible for assessing IR35 status as per the public sector rules

What Is Changing In April 2020?

Both the old and new legislation hinges around the classification of "deemed employees" – that is, whether the worker is truly a contractor or whether they are a disguised employee. This remains the central concern of IR35.

The newer IR35 legislation brings into force alternative tax treatments which mean that companies are now responsible for assessing the contractor's employment status – and that they should pay employment taxes over and above the fees paid to the worker.

Currently, there are different rules for public- and private-sector companies. The public sector rulings have been in place since 2017 and indicate that the hiring company/organisation is responsible for assessing whether the contractor falls inside or outside of IR35. If the hirer decides that the worker

falls inside IR35, tax and NI contributions should be deducted and the worker's status reported to HMRC.

In April 2020, private sector contracts will be brought inline with the public sector. Prior to the 2020 deadline, it was the contractor's responsibility to calculate their own position inside or outside of IR35. From 2020, private sector employers will now be responsible for assessing IR35 status as per the public sector rules.

Why Is Correct Classification Important?

Time and again, we have seen organisations misclassify their workers as independent contractors or self-employed as an easier, cheaper option or because they are unfamiliar with local laws. If the employee takes the case to tribunal and wins the ruling, this can equal huge compliance headaches for the company including fines, backdated taxes and employment contributions, and greater scrutiny of company taxes as a whole.

Recent employment tribunals have been brought against proponents of the gig economy using workers they deemed to be "self-employed contractors", such as Deliveroo, CitySprint, Uber and Pimlico Plumbers. In some of these cases, tribunals decided that these companies had classified their workers incorrectly; as they were contributing to the success of the business and not working solely for themselves, the individuals were not self-employed and should be provided with standard employment rights in line with UK labour law such as sick and holiday pay, working hours and breaks, National Minimum or Living wage.

With the arrival of IR35 for private companies next year, the importance of correct classification will increase further – if workers are deemed to be within IR35 following an investigation, HMRC will demand retrospective PAYE tax and National Insurance contributions dating back as far as 6 years. If underpayment is deemed to be deliberate or based on careless practices, fines can be imposed.

What Is The Criteria For A Deemed Employee vs A Contractor?

There are a number of factors which determine whether a worker is considered a contractor or

employee, such as the amount of supervision, direction and control that takes place, the way in which they are paid, the equipment they receive, whether they are engaged in contracts with more than one client, the level of financial risk they bear, whether employees report into them, how ingrained they are within the organisation and so on.

At Mauve, we use the 20-factor Test to determine a worker's classification – the test defines a worker as a "service provider". The questions must be objectively and consistently applied in order to determine the worker's correct status – if the majority of answers to the 20 questions are "yes", the service provider is more likely an employee, and if the majority of answers is "no", the service provider is most likely an independent contractor.

The 20 questions are as follows:

1. Is the service provider directed by the client as to when, where and how the work is to be done?
2. Is the client providing detailed instructions or training to enable the service provider to perform the work in a particular way or manner?
3. Can the service provider perform the work without any risk of direct economic loss to himself/ herself?
4. Are the services provided by the service provider an integral part of the client's operations, like those already performed by others within established job classifications (e.g. clerical work, teaching or research)?
5. Must the services be performed specifically by the service provider (rather than someone else employed by the service provider)?
6. Will the client hire, supervise or pay others to help the service provider on the job?
7. Is there a continuing work relationship between the service provider and the client for which the services are being performed?
8. Is the work schedule set by the client?
9. Is the service provider required to devote his/her full time effort to the client for which the work is being performed?
10. Is the work required to be performed at the client's premises, or in specific places designated by the client?
11. Is the sequence of work set by the client?
12. Are regular oral or written reports required to be submitted to the client by the service provider?
13. Is the method of payment based on hourly, weekly or monthly fees (as opposed to commission or by the project/job)?
14. Are business and/or travel expenses reimbursed?
15. Does the client furnish the tools, equipment and materials used by the service provider?
16. Can the service provider perform the work without making or having made any investment in equipment or facilities?
17. Does the service provider perform services exclusively for the client rather than working for a number of companies at the same time?
18. Does the service provider not make his/her services regularly available to the general public or businesses other than the client?
19. Is the service provider subject to dismissal for reasons other than non-performance of contract specifications?
20. Can the service provider end his/her working relationship with the client at any time?

For the purpose of IR35, the best way to determine a worker's status is to use HMRC's online tool, available from their website – as HMRC inspectors will be tasked with proving deemed employee statuses in order to bring cases to court, their classifications and resources are the most definitive.

How Will IR35 Impact Contractors?

Genuine contractors should not be impacted – it is important however, to be completely clear about the factors that determine worker classification.

The most obvious impact is on those contractors who are re-assessed as "deemed employees" - this could mean that tax and NI obligations will need to be paid on their income. Deemed employees are also due certain employee benefits such as sick and holiday pay; a sudden change to full employment may be a shock for workers accustomed to the flexibility and reduced tax obligation attached to being a contractor.

The new IR35 rules will to some extent move responsibility away from the contractor and on to the engaging firm – however, contractors should remain abreast of their own situation and status so that changes do not come as a surprise. The change to employment will of course affect their limited company or any contractual relationship with a third party "umbrella" payroll company.

How Will IR35 Impact Companies Or Hirers?

The largest impact will be the shift to the engaging company having full responsibility for the assessment for IR35 status of workers. Companies who may be affected should spend the next 9 months learning the intricacies of IR35 or engaging the right support to help them make correct assessments. They will also need to put in place the correct internal procedures to ensure the right contracts and payroll arrangements, while also managing the expectations of the workers.

Tax liabilities in 2020 will be moved from the worker to whomever pays the fees – in some cases, this will be recruitment agencies. This has caused some controversy because the end client or engaging party is still responsible for assessing IR35 status – recruiters or fee-paying organisations could be liable for extremely large tax bills if end clients make slapdash IR35 decisions. HMRC have stated that if there is evidence of negligent behaviour on the part of end clients, they too may be liable to be penalised. It is therefore imperative that workers, any third parties, recruiters and end clients work together and keep constant open lines of communication to ensure correct decision-making.

Companies should be wary of simply actioning a blanket shift of all contractors into IR35 – the legislation is intricate and each case requires thorough consideration. This type of action can result in contractors paying employee-level tax without the employment rights they are due in return.

What Should My Next Steps Be?

The IR35 legislation will prevent non-compliance and associated underhand practices – it is fundamentally beneficial to all. However, the deadline is fast approaching - any organisation engaging UK contractors should make themselves abundantly understanding of the new IR35 rulings.

The tide is turning in the UK and around the world as a result of the rise of the gig economy and clamp-downs on dishonest tax strategies. Businesses should keep compliance at the forefront of their minds at all times, and ensure their classifications and internal processes are compliant to the letter of the law.



ANN ELLIS

Chief Executive Officer

As one of Mauve's founders, Ann was the first and only "back-office" employee in the early days, providing services and support to telecoms projects. Today, Ann's role as CEO is just as energetic and she is profoundly involved in the business at every level. Ann is multi-lingual and enjoys experiencing new cultures as she travels the world expanding the organisation's infrastructure.

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