

HE Briefing Note Managing IR35 Requirements

December 2021

Background

On 09/03/1999, the Inland Revenue issued a press release called *'Countering Avoidance in the provision of Personal Services'* outlining Government plans to restrict the use of sole shareholder/director limited companies ('Personal Services Companies') to provide professional services to clients to (allegedly) reduce liabilities to tax. This became law in 2000 (via the Finance Act 2000) and the rules, whilst going through several changes and iterations, are still in place today.

In 2015, the Government released a document called *'How to make IR35 more effective in protecting the Exchequer'* which highlighted the possibility that organisations engaging individuals may be required to determine their employment status. In March 2016, the Government confirmed that there would be changes to IR35 legislation to consider in more detail 'off-payroll working' within public sector organisations which became effective from 06/04/2017. This required public sector organisations ('clients') to assume responsibility for determining whether individuals engaged for services were inside or outside the IR35 legislation. If individuals were assessed and deemed to be in an employment relationship, it became the responsibility of the client for treating the individuals as an employee and accounting for PAYE and National Insurance Contributions at source on behalf of HMRC.

A technical note¹ was published by HMRC which set out the practicalities

¹ [Off-payroll working in the public sector: reform of the intermediaries legislation - technical note - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/614242/Off-payroll-working-in-the-public-sector-reform-of-the-intermediaries-legislation-technical-note.pdf)

of IR35 legislation requirements. This change required, in many cases, new processes and controls to be created in organisations which had not previously had to make these determinations themselves but relied on the contractors they were engaging. To support understanding of the legal change in responsibilities, HMRC published guidance in February 2017 for clients and contractors setting out the new rules.² Additionally, HMRC launched the Employment Status Test ('ESS') to assist with the employment status determination for tax purposes of individuals for establishing whether they were inside or outside IR35. The ESS became the 'Check Employment Status for Tax' ('CEST') tool currently used for status determinations.

This paper considers the impact of the IR35 legislation from an HE perspective following on from recent work undertaken in this area on the relationship between institutions and individuals engaged for services, the current requirements (including the April 2021 update to the legislation), the risks to demonstrating these have been achieved and the way ahead for employment status determinations for tax purposes.

IR35 Legislation changes from April 2021

From 06/04/2021, all organisations covered by the IR35 legislation (both public and private sector) are required to determine the employment status for tax purposes of every worker who operates through their own intermediary, even if they are provided through an agency. An additional

² <https://www.gov.uk/guidance/off-payroll-working-in-the-public-sector-reform-of-intermediaries-legislation>

requirement is that any determination made should be communicated to the individuals using a 'Status Determination Statement' ('SDS').³

Government guidance states that an SDS must:

- i. be passed to the worker and the person or organisation you contract with
- ii. give your conclusion and the reasons for coming to it.

To support this, organisations are expected to:

- i. take 'reasonable care' when making a determination
- ii. make sure detailed records of employment status determinations are retained (including the reasons for the determination and fees paid)
- iii. have processes in place to deal with any disagreements that arise from determinations made
- iv. confirm the size of your organisation (if asked by the person or organisation you contract with, or the worker directly).

Where it is deemed that the IR35 legislation applies to the worker engaged, the organisation performing the assessment is required to calculate the tax and national insurance applicable.

Key risks to IR35 compliance

The following risks should be fully considered to ensure that IR35 processes in place are fit for purpose in demonstrating compliance:

³ [April 2021 changes to off-payroll working for clients - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/news/april-2021-changes-to-off-payroll-working-for-clients)

- The institution is unable to demonstrate to HMRC that it has exercised reasonable care when determining the employment status of workers. This may be more of an issue in HEIs where several stakeholders input into the assessment process and incorrect reliance is placed on other areas to complete required checking.
- Workers may be incorrectly assessed when determining whether IR35 or employment status rules apply potentially resulting in liabilities which have not been identified through the assessment.
- The institution may make incorrect PAYE and National Insurance payments to HMRC due to incorrectly determining the employment status of workers, potentially resulting in financial loss. This issue is potentially more apparent within HEIs where status determinations are not managed by Finance but academic schools and faculties.
- Lack of clarity over assessment results leading to inappropriate judgements over determinations from the CEST online tool.
- Failure to maintain clear evidence supporting the rationale for an IR35 determination could lead to challenge and review by HMRC.
- Contractors deemed to be inside IR35 when they believe they should be assessed as 'outside' (particularly where they provide services to other organisations which have been deemed outside IR35) could lead to a reduction in available

workers for the institution. This could result in ineffective management of projects through lack of suitably experienced and available resource. Again, this is a potentially significant issue within HEIs where IT and Estates resource is engaged through contractors arrangements.

- Failure to correctly complete and issue Status Determination Statements to individuals and contractors leading to non-compliance with post April 2021 requirements for IR35 assessments, hence the issue of this paper now.
- Restricting the management of the IR35 compliance process to HR functions within the institution may result in key financial implications being missed through lack of appropriate taxation specialist knowledge.

Best practice for managing IR35 compliance

Given the above areas of risk to demonstrating IR35 compliance, the following are controls which we have seen in place in HE institutions which we consider are best practice in mitigating and managing risks should they crystallise:

- Clear process documentation in place for IR35 assessments which sets out:
 - i. the steps taken to undertake employment status determinations
 - ii. guidance setting out the responsibilities for recruiters within the organisation in engaging external workers
 - iii. how determinations of employment status for tax purposes should be made and recorded

iv. version control to ensure processes are updated with changes to legislation on a timely basis.

- A clearly defined methodology for the retention of evidence for each employment status determination made for workers engaged. This is vital in demonstrating the assessment was undertaken as required. From recent work undertaken with HEI clients, this was observed as a strong indicator of robust controls in place over IR35 processes.
- Ensuring that the finance and taxation teams of the institution have an input into the management of the process for undertaking IR35 assessments, given that the principal objective of the legislation is to ensure that the employment status of workers is correctly assessed for tax purposes. In one HEI recently reviewed, it was observed that multiple stakeholders were involved in the IR35 process across different functions which positively impacted the completion of the process.
- Using external agencies for the provision of contractors for services who themselves use umbrella companies, reduces the risk of exposure to non-payment of income tax and national insurance as any liabilities identified will remain with the umbrella company or the agency contracted with. A recent review of a larger HEI indicated that agencies were used where contractors were operating through umbrella companies.
- Where agencies were engaged by the institution to provide contractors, the agency contract terms clearly set out the responsibility for the calculation and payment of tax and national insurance where an employment relationship was

deemed to exist. Again, in one HEI recently reviewed, we observed that contractor agencies used retained responsibility for a significant part of the IR35 requirements and accounting for tax which removed the burden from the HEI.

- As Status Determination Statement requirements have been introduced from April 2021, we advise that there is a clear communication framework in place for communicating employment status determinations and their rationale to individuals and contractors to ensure that:
 - i. Status Determination Statements comply with the requirements set out by HMRC⁴
 - ii. Individuals and contractors clearly understand the determination to enable informed decision-making over whether they wish to enter a contractual arrangement with the organisation
 - iii. All parties are clear on the arrangements in place for the provision of work by the individual or contractor.
- A sufficiently comprehensive training programme for all recruiting managers with responsibility for the engagement of individuals and contractors either directly or through agency arrangements was observed in larger institutions reviewed. This was typically overseen by one area of the institution (such as HR or Finance). We would recommend that this is regularly reviewed to ensure that updates to legislation are captured and communicated on a timely basis.

- Having clearly defined responsibilities within the institution for managing the IR35 process ensure that all requirements of the legislation are clearly assigned, and key components are not missed.
- In one organisation, whilst IR35 requirements were satisfactorily managed, we recommended that a central repository was created and maintained to capture all IR35 employment status determinations. This would provide all stakeholders to the process with a detailed schedule of the IR35 status of any given arrangement with individual contractors to ensure all requirements have been met.

We would recommend that institutions consider the insurance arrangements in place to ensure that cover is in place to mitigate the risk of incorrect status determinations and potential future tax liabilities arising from these through the findings of HMRC investigation activity.

In one institution, we noted that standard IR35 determination statements had been created for similar roles across departments (to avoid running an assessment for every new contractor). From our review of the legislation, care should be exercised in creating standard IR35 determination statements for similar roles as, whilst roles may appear the same they may have small differences in requirements which would cause the assessment to result in an inside IR35 determination.

⁴ [ESM10014 - Employment Status Manual - HMRC internal manual - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/90144/ESM10014_-_Employment_Status_Manual_-_HMRC_internal_manual_-_GOV.UK.pdf)

Other considerations

Given the development of the IR35 legislation since its inception in 2000, further changes by HMRC to the requirement to assess workers' employment status for tax purposes are anticipated to ensure that the legislation remains appropriate and fairly applied to the engagement relationship between individuals and institutions. Listed below are some other areas for consideration regarding IR35 legislation:

- A consideration over whether to continue to engage individuals operating through PSCs and undertaking IR35 assessments of the engagements entered or end these relationships in favour of issuing fixed term employment contracts to workers engaged. The advantage of engaging with individuals operating through PSCs is the wider access to knowledge and experience which may otherwise not be available for individuals engaged as employees.
- The obvious disadvantage of engaging workers as employees is the extra burden of accounting for tax and national insurance, the cost of employers' national insurance and auto-enrolment workplace pension responsibilities which, where an outside IR35 relationship is established are not the responsibility of the client institution.

⁵ <https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm10014>

- An additional consideration is that not all institutions are necessarily the 'end client' for the purposes of IR35 legislation. Where an institution is considering filling a role, HMRC will consider it as the decision-maker in the process and it must issue a Status Determination Statement which should be issued to the individual engaged. Where an individual contractor's 'end client' (i.e., the institution) outsources the project to a third party to manage activity, HMRC will consider that third party as the end client who takes on the decision-making for the PSCs it manages.⁵

Where the institution is requesting the third party to undertake specific roles, it will retain the decision-making responsibilities (and completion and issue of SDS), whilst the third party – such as an agency – will have the role of 'fee payer' for the PSCs engaged.⁶ This may particularly be relevant where an IT consultancy third party is engaged.

- It is also worth noting that 'small companies' as defined by HMRC⁷ are exempt from IR35 legislation meaning that, where contractors are engaged, the decision-making and liability for payment of tax and national insurance lies with the PSC. Where a third party engaged is therefore classified as a small company, the initial end-client does not retain any IR35 assessment responsibility or any potential tax liability. This is particularly important where small companies are engaged to provide contractors for projects within the organisation.

⁶ <https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm10010>

⁷ <https://www.gov.uk/annual-accounts/microentities-small-and-dormant-companies>

- It is crucial that the IR35 responsibilities are established and clearly defined. In the future, HMRC may focus some compliance assurance activity on contracts where IR35 exempt small consultancy companies are used to ascertain that these are not being used to avoid responsibility for their legal obligations.
- Agencies used by the end-client organisation to provide individual contractors for projects are defined as the fee payer in the relationship with the PSC the individual contractor is using. Because of this relationship, the agency will become liable for any uncollected tax due from the PSC if the end client's IR35 assessment process has resulted in errors, irrespective of the level of care taken by the organisation. It is critical that, where agencies are used, the contractual arrangements are clear and that IR35 assessment responsibilities are clearly defined and understood.

We can help

We have knowledge and experience of HMRC's IR35 regulations as applied to the management of contractors and suppliers providing services to Higher Education Institutions.

Uniac can provide an assessment of the current processes and controls in place to manage IR35 to provide assurance that these comply with current HMRC requirements. For further information on how we can help, or for any other aspect of Uniac's internal audit and assurance service, please do get in touch.



Graeme Chambers
Senior Assurance and Audit Consultant
e: gchambers@uniac.co.uk
www.uniac.co.uk



Richard Young
Director
t: 07795 122 252
e: ryoung@uniac.co.uk
www.uniac.co.uk