IR35 – the u-turn nobody saw coming

Lorraine Payne looks at the impact of the mini-budget announcement repealing the reforms to IR35

Last week, in what was seen as an unexpected u-turn, Chancellor Kwasi Kwarteng announced the Government will scrap the 2017 and 2021 reforms to the IR35 off-payroll working rules.

'Reforms to off-payroll working have added unnecessary complexity and cost for many businesses,' said Mr Kwarteng, addressing the House of Commons during his mini Budget statement on Friday morning.

The Treasury's Growth Plan document, published shortly after the Chancellor delivered his statement, revealed that repealing IR35 reforms is among the first steps the Government is taking to simplify the tax system. It says the change will free up time and money for businesses that engage contractors, which could be put towards other priorities. It will also minimise the risk genuinely self-employed workers are negatively impacted by off-payroll rules, it claims.

What is IR35?

IR35 is the commonly used term for legislation introduced in 2000 to tackle the misuse of personal service companies (PSCs) for tax avoidance purposes. The aim was to clamp down on individuals working in a manner similar to an employee, but under the guise of a limited company.

Freelancers operating through a PSC have the ability to pay themselves a lower salary and the rest of their 'salary' as dividends, thereby paying lower income tax and paying lower NI contributions.

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Originally, it was up to individuals to assess whether they fell under IR35. However, since reforms in 2017 and 2021, the onus has been on businesses and public authorities to decide the status of their contractors.

The rules apply if a worker provides their services to a client through an intermediary but would be classed as an employee if they were contracted directly.

If the IR35 rules apply, income tax and employee national insurance contributions must be deducted from fees and paid to HMRC. Employer national insurance contributions and apprenticeships levy must also be paid.

Compliance

'We will continue to keep compliance closely under review,' Mr Kwarteng claimed. This is the trickier part; these reforms will likely make using interim/contractors a simpler process for end users (clients) but the Government will be keen to ensure there isn't an increase in tax avoidance associated with this change. The rules were [originally] changed because HMRC thought 90% of contractors weren't applying the rules correctly.

Penny Simmons, legal director at law firm Pinsent Masons, said it is important for businesses to remember it is just the reformed IR35 rules that are being repealed. 'The rules will still exist – it's just that contractors will once again be responsible for compliance and payment of tax,' she said. 'Businesses will remain exposed to tax risks by virtue of other tax rules and the corporate criminal tax offences – if they pay contractors off-payroll when they know the contractors should be taxed as employees.

How these IR35 reforms could affect you

These reforms could:

- Put the determination of IR35 status back to the candidate, should cut down internal process regarding hiring contractors, however candidates need to ensure they are applying the rules correctly.
- Give potential cost reduction to a client if candidates are deemed outside IR35. Candidates will be able to claim travel and accommodation expenses against their companies and are more likely to travel for roles.
- Encourage more individuals back into the contracting/interim market as you will now be able to work via a personal service company again. Blanket IR35 rulings should be a thing of the past.

It's positive news for many but let's be clear here, the Government is not expecting a reduction in tax/NI income from contractors. What they want is to take the onus of determining the status of the role from companies and put it back on the individual, as it was pre-2017. It is being changed to reduce the burden on businesses, so they can concentrate on other things. This gives people a chance to get IR35 right, but everyone also needs to be mindful that the actual tax obligations are still the same after April 2023.

There is also the question, will this actually happen? Until it is in statute via the next Finance Act it is not law, so the earliest these changes will be introduced is April 2023.

By repealing IR35 reform, the Government has effectively admitted that it has not worked. Whatever your experience with IR35, it has changed how clients recruit interims and also how candidates work within this market. If it can be simplified it will be a welcomed boost to the UK flexible labour market. ■

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