LIQUID FRIDAY

IR35: Three Months On

How does the contracting landscape look now?

FCSA Accredited Member

REC Business Partner

TEAM SERVICE PROVIDER

Overview – by Sam Pascoe, Commercial Director, Liquid Friday

"Leading up to the IR35 Reform being implemented in the private sector, we found that most agency partners prepared early for this change with effective communication to their consultants, end clients and candidates. A protracted period of education was required at all levels to ensure each part of the supply chain understood their responsibilities and risks associated with the new regulations.

Since the implementation in April 2021, we have seen that agency partners have worked more closely with Liquid Friday as their support partner and in turn with their end clients to better provide assistance with the new rules around IR35.

Ultimately, the changes have resulted in more roles being found to be inside IR35 or many end clients making the decision to cease the use of Contractors who operate through a Limited Company altogether, due to the risk and admin burden this may bring – the latter being the most prevalent outcome.

The results of this has led to candidate skills shortages in many sectors, from Logistics (where Limited Company arrangements were wrongly prevalent) Engineering, IT, Healthcare & Finance. There are other situations whereby assignment rates have had to increase to retain crucial skill sets, particularly in the Engineering sector.

The reform has largely achieved the objectives of HMRC though, as many contractors that would have operated through a Limited Company (outside of IR35 – potentially incorrectly) are now operating through Agency PAYE, Umbrella PAYE or have been directly engaged by the end client – producing a valuable increase in treasury contributions.

The reform has also been seen to 'level the playing field' somewhat so that two contractors doing the same work in the same way, but one may have previously operated outside of IR35 incorrectly and had benefited from the improved take home pay, now has the same levels of taxation applied.

We have seen an increase in non-compliance too, particularly aimed at the Logistics sector with hub/platform style arrangements offered to enable substitution – leading end clients to believe this circumvents the IR35 reform allowing HGV Drivers to continue to operate outside of IR35 through their Limited Companies, which of course it doesn't as many other factors need consideration for a status determination for IR35 – substitution being only one part of it. We believe the HMRC need to take swift action against the companies marketing these non-compliant arrangements to avoid significant risk being passed up the supply chain to end clients and also downwards to contractors."

Wider Economic Backdrop

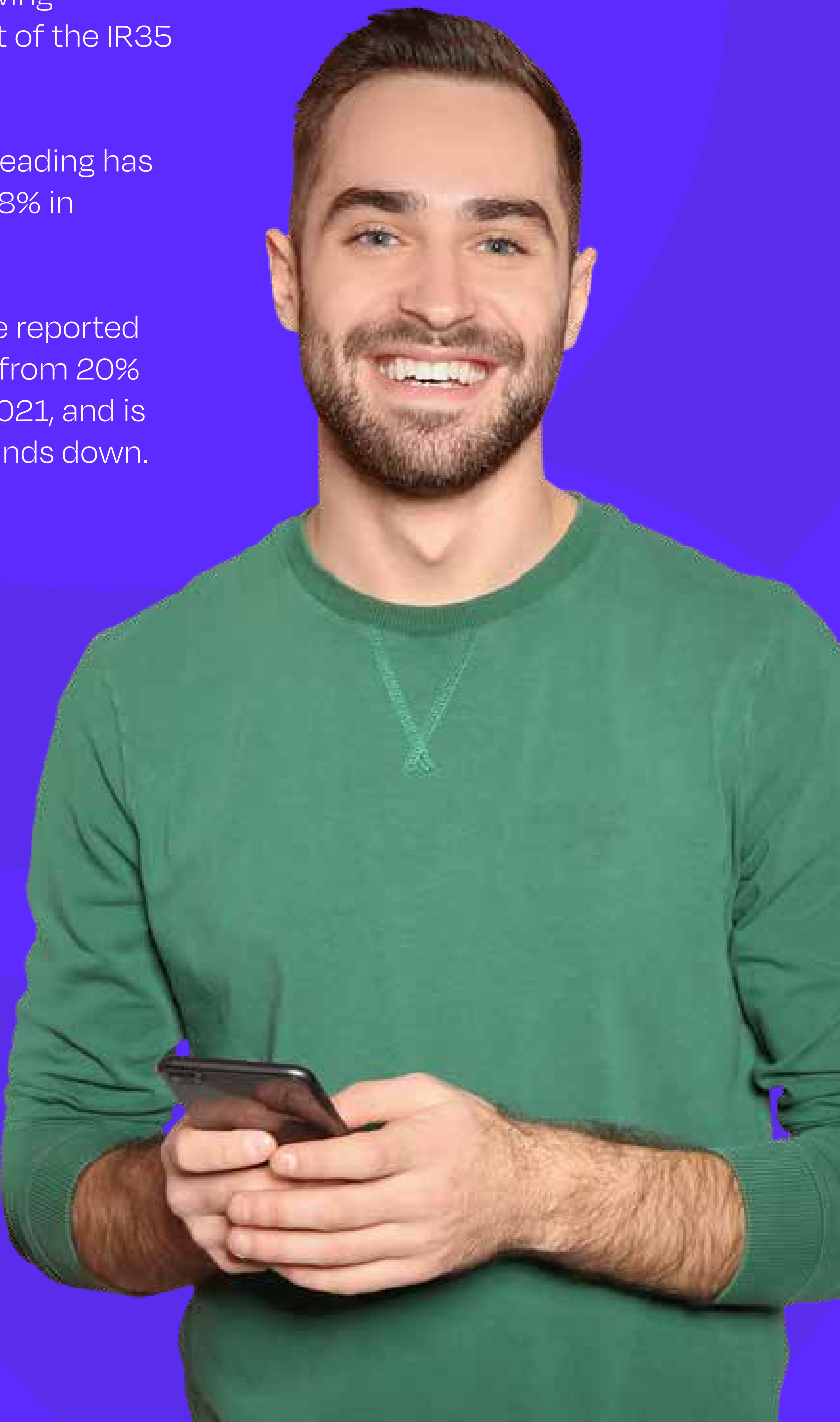
The off payroll reforms were of course delayed for a year because of the more immediate crisis of Covid. Therefore it is impossible to ignore the fact that the IR35 changes, and their subsequent bedding-in period, has been played out against the backdrop of the pandemic.

After what has been a long and challenging road, it appears as though the end is in sight. With England's roadmap out of lockdown now reaching its final stages, latest statistics show that things are slowly but surely returning to normal.

The pace of recovery has varied by sector and has been influenced by other factors. For example, new rules following the end of the EU exit transition period have compounded the challenge of recovery for certain industries.

The latest BICS (Business Impact of Covid-19 Survey), published by the ONS has revealed the following economic insights, against which the impact of the IR35 reforms should be considered:

- The percentage of businesses currently reading has increased steadily from 71% in 2021 to 88% in late June 2021.
- The proportion of the business workforce reported to be on full or partial furlough has fallen from 20% in late January 2021 to 6% in early June 2021, and is expected to fallfurther as the furlough winds down.
- The percentage of currently trading businesses that reported lower than normal turnover continued to fall, from 65% in June 2020 to 30% in early June 2021.
- The transportation and storage industry had the lowest percentage of businesses trading in late June 2021, at 76%. This has declined steadily from 94% in early October 2020, at a time of media reports of lorry driver shortages.



Impact of IR35 – Key Observations

Three months after the initial transition of the off payroll changes in the private sector, IR35 is still riding high on the ag enda of many recruiters.

In a recent survey carried out by Liquid Friday, recruitment consultants ranked IR35 as their biggest challenge after candidate generation.

As the new IR35 regime continues to settle and become the norm, here are some of the notable effects that have arisen over the last three months since its implementation:

Candidate Shortages

A survey of 1850 contractors carried out in late April by the advisory firm Qdos, gave one of the earliest indications of how contractor engagement was set to look. It found that 65% of contractors had been assessed as employed for tax purposes, or "inside IR35", while 35% had been assessed as self-employed for tax purposes - "outside IR35".

Indeed, many hirers imposed blanket bans dictating that Limited Company contractors could not be used on projects. Combined with other factors, most notably Covid and the "Brexodus" of European workers, this has led to a serious shortage of candidates in certain sectors.

This has been most publicly visible in Logistics, where IR35 is said to be fuelling a shortage of HGV drivers as big as 100,000. No doubt many of us will have seen the media reports of sweets giant Haribo, which said it was struggling to get stock into shops as a direct result of the UK-wide lorry driver shortage.

Engineering, IT, Healthcare & Finance have also been impacted. Contractors with specialist niche skills in these areas, don't want to enter into PAYE arrangements, and this is causing a narrowing of the talent pool available to recruiters.
In a report commissioned by a top UK recruitment company, more than 8 in 10 organisations have found it difficult to hire IT contractors for example.

Those who are able to continue working outside of IR35 have been able to leverage their skills in the market and drive rates up. In a survey carried out by inniAccounts.co.uk, 55% of contractors outside IR35 said a shortage of niche skills has increased their bargaining power with clients, with the same research showing that those with a status inside IR35 were not getting the same bargaining powers.

Impact of IR35 – Key Observations

Have the reforms achieved what HMRC wanted?

April's IR35 reforms in the private sector were the biggest change to employment tax for decades. According to HMRC, the cost to the treasury of non-compliance with the off payroll working rules in the private sector would have reached £1.3 billion a year by 2023/24.

HMRC's objective was of course primarily, to increase treasury receipts, but also to ensure that the off payroll rules were being applied consistently across the board.

In 2019 HMRC reported that the public sector reforms, introduced in April 2017 had increased their tax take by £550 million.

It was fairly inevitable therefore that they should be extended to the private sector, albeit delayed by a year due to the pandemic..

Since the IR35 changes came into force in April, reports indicate that nearly two-thirds of contractors have been classified as "employed for tax purposes".

Quantitative data on the increased tax take is not yet available and won't be for some time, until the treasury books are balanced for the current financial year. Detractors will warn that increased revenue from PAYE tax and Employers NI should be offset by a reduction in the overall amount of Corporation Tax paid, to get a realistic picture.

Impact of IR35 – Key Observations

Non-compliance, HMRC guidance + the push to regulate

Prior to April, it was widely predicted by recruitment and contracting bodies that there would be a proliferation of non-compliant tax arrangements once the IR35 changes were implemented.

Anecdotally we have definitely seen this to be the case, with various schemes cropping up which claim to circumvent IR35 in one way or another.

The changes in responsibility and determination of IR35 meant that for many contractors, working through a limited company was simply no longer viable. This has driven a shift to umbrella company working, with 64% of contractors (surveyed by Qdos), being told they could work via an umbrella company post-IR35.

In May, HMRC issued updated guidance aimed at agency workers and contractors, providing information on how umbrella companies work, what to expect and what to avoid.

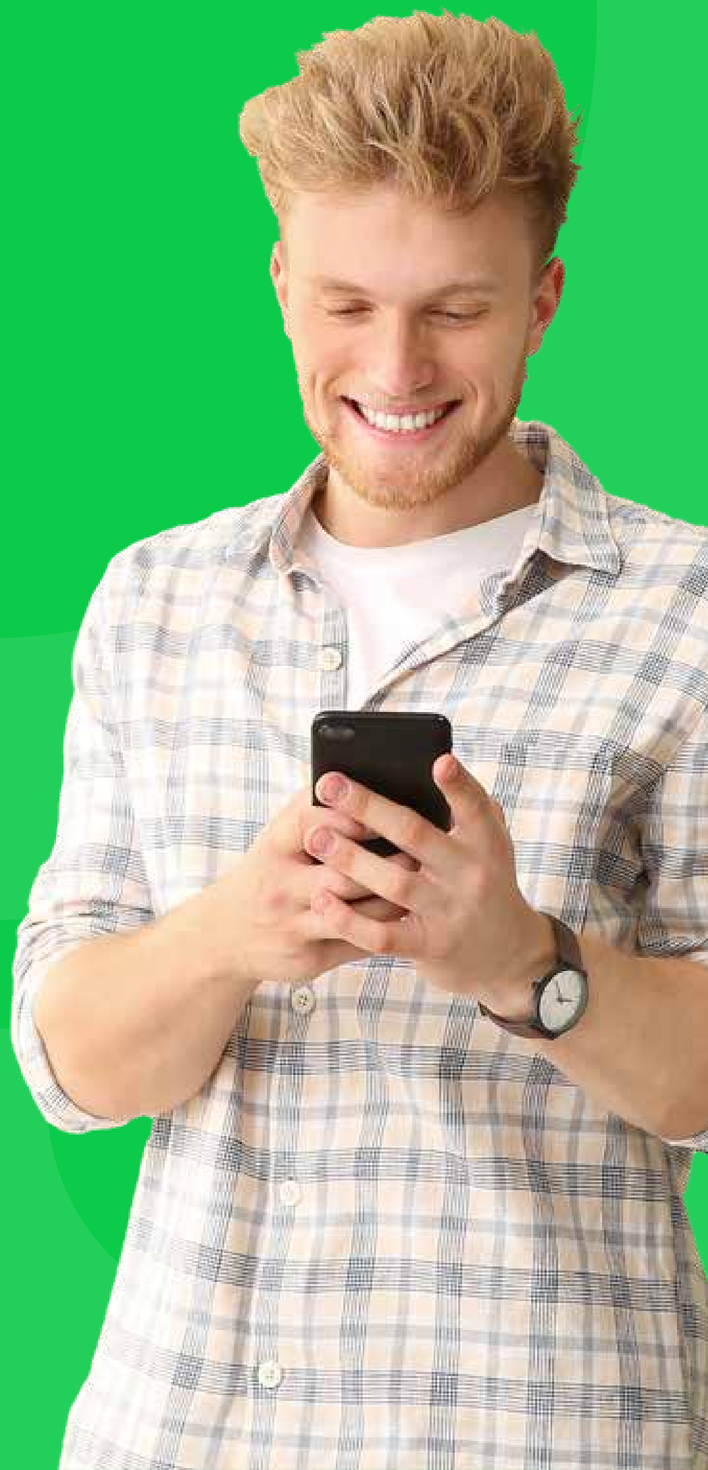
They followed this up with guidance for businesses on how to mitigate risk in the labour supply chain, urging the principles of "Check, Act, and Review".

FCSA Chief Executive, Phil Pluck, emphasised this, commenting:

"Labour supply chain due diligence is vital, now more than ever as we see increasing numbers of contractors moving into the umbrella model following IR35, and the rise we are seeing in unscrupulous payment intermediary providers and the scams they promote."

While of course many umbrella businesses are wholly legitimate, the lack of central regulation of the industry has come under increased scrutiny over fears that unscrupulous providers are exploiting workerss and trapping them into tax avoidance.

Liquid Friday has added its voice to that of the FCSA and others in calling for Government regulation. It felt that now that HMRC have outlined what correct, compliant umbrella employment looks like, they will go one step further and regulate the industry, in order to stamp out exploitative practices and create a fair and level playing field.



Looking back... AND FORWARDS!

To summarise the reforms very quickly:

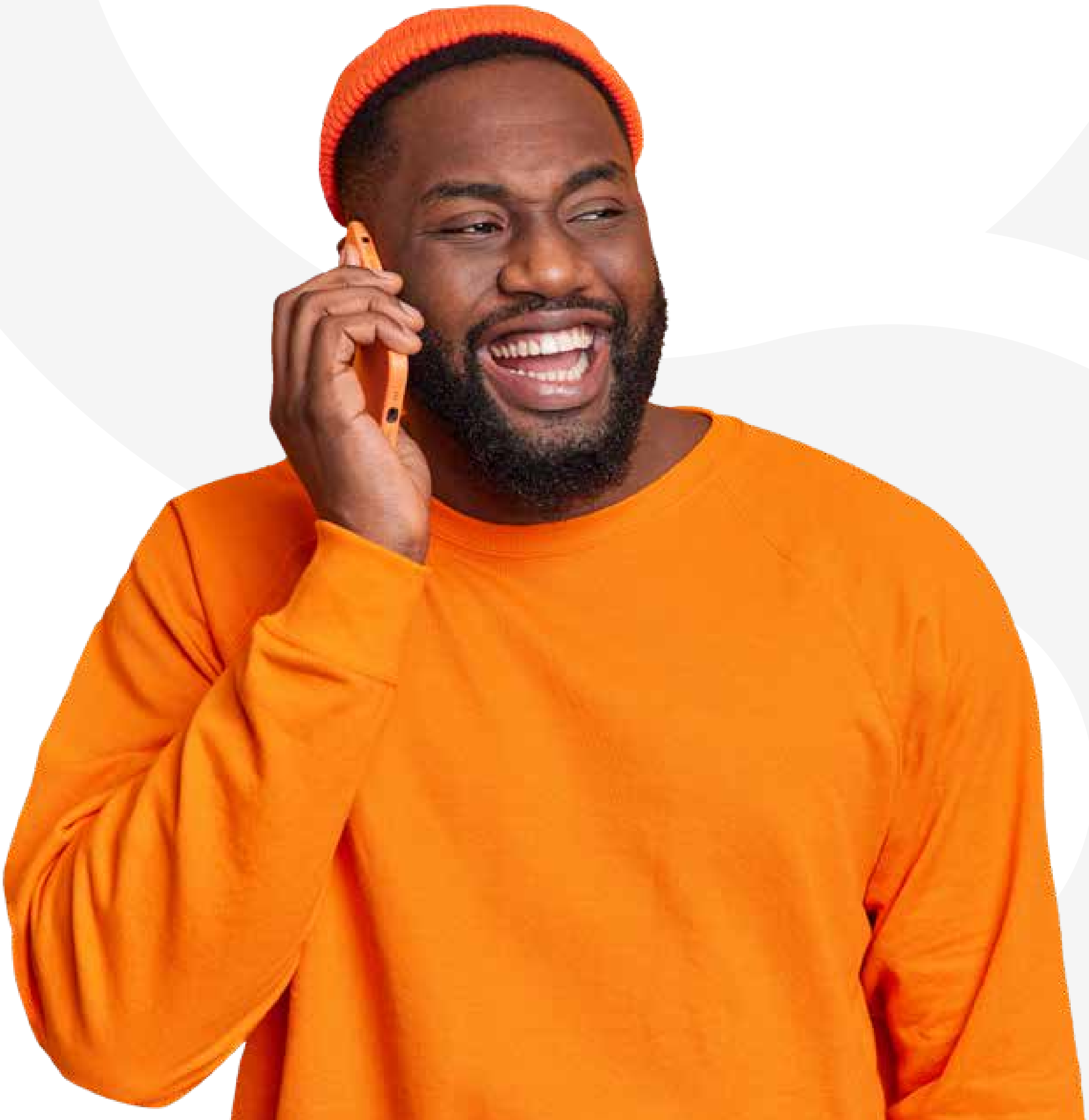
From 6th April 2021 for all medium and large organisations (as per Companies House definitions), the end client is responsible for determining the IR35 status of Limited Company contracts.

Clients must pass a "Status Determination Statement" (SDS) down their supply chain to the party paying the PSC, whose responsibility it is to ensure appropriate deductions of tax and NIC.

If one party gets it wrong, and HMRC can't recover the debt, liability can be passed all the way up the supply chain.

Three months on, the way IR35 is now applied is here to stay; it is the status quo.

At Liquid Friday we helped hundreds of recruitment agencies and thousands of contractors navigate the IR35 transition. We remain fully committed to providing the unrivalled service and support our clients need to achieve their goals in this post-IR35, post-pandemic world.



LIQUID FRIDAY

02392 883300

HELLO@LIQUIDFRIDAY.CO.UK

WWW.LIQUIDFRIDAY.CO.UK

FCSA Accredited Member

REC Business Partner

TEAM SERVICE PROVIDER