Reform of IR35

The Government is consulting on options for reforming the IR35 legislation to make it more effective, including the possibility of placing responsibility for compliance on those businesses engaging workers through personal service companies.

The Government has published a short consultation document on possible reform of the intermediaries legislation (IR35), which puts forwards the possibility that engagers of personal service companies (PSCs) may be made responsible for operating the legislation and deducting income tax and NICs.

The short consultation document seeks to set out a framework for discussing options for reform of the IR35 rules and does not, as yet, put forward any firm proposals. However, many businesses will be concerned that the Government is considering extending responsibility for this difficult area of law to those who engage workers through PSCs.

Background

The IR35 legislation was introduced in 2000 to address the growing use of personal service companies to avoid employment status. By doing so, both worker and engagers gain potential tax advantages, including lower amounts of both NICs (for engagers and workers) and income tax. The Government remains firmly of the view that the use of PSCs to “disguise” employment status is unfair and presents an unacceptable risk to the Exchequer.

However, the Government is also concerned that the IR35 legislation is not working as it was intended. This is supported by recent reports both from the OTS and the House of Lords Select Committee on Personal Service Companies, which concluded that the legislation is complex to administer and often simply ignored by those working through PSCs.

Improved administration of the IR35 rules by HMRC is seen as important, but not a panacea. In essence, the Government admits that IR35 cases are so complex and time consuming that HMRC cannot possibly deal with the issues of non-compliance simply through a targeted risk based approach.

Discussion

The consultation document estimates that some £430m is lost to the Exchequer as a result of non-compliance with the
IR35 rules and that, as a result, further reform of the IR35 rules is necessary.

Rather than making specific proposals, however, the discussion document seeks to frame the future debate by setting out the objectives that need to be considered in relation to reform. These are:

- the need to protect the Exchequer, and
- levelling the playing field between employees and those who would be employees but for the use of a PSC.

Making the legislation as straightforward to comply with as possible, and not creating disproportionate burdens on businesses or individuals, are core principles for the reform - which may be easier to state than to actually fulfil.

There is no intention to widen the scope of IR35, however.

The consultation expressly recognises the complexity of the problem and difficulty of creating a system that meets the objectives set out. In particular, the document recognises that any reform will most likely have some impact on those businesses that are genuinely self-employed and operate through a company for non-tax reasons.

Whilst the document opens the debate on possible reform, and requests any and all suggestions which might meet the objectives set out, the one specific option mentioned in the document is to place the burden of deciding whether the IR35 legislation applies onto the person engaging the PSC. If the engager concludes that the PSC is within the IR35 rules, then the engager would be required to deduct income tax and NICs as they would for direct employees.

Views are requested specifically on this suggestion, whether there are particular sectors which might face particular challenges from it and whether it should apply to all engagers (eg individuals).

A related suggestion would be to achieve some form of simplification in the test for determining whether IR35 applies, possibly aligning it with that used for temporary workers in the agency rules (based on supervision, direction or control).

**Comment**

The original proposals for IR35 put forward when it was introduced envisaged placing the burden for operation on those engaging PSCs. Following significant negative feedback, the Government of the time dropped that requirement in favour of requiring the PSC itself to operate the rules. Businesses will, no doubt, be as concerned now as they were then about the suggestion that they should take on the difficult burden of determining if any PSC they engage falls within or outside the complex IR35 rules.

The consultation document is open for comments until the end of September 2015 and comments should be sent to ir35.reform@hmrc.gsi.gov.uk.

To view Simmons & Simmons response to the consultation, see our item "IR35 discussion document: Simmons & Simmons response".

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