



The end of IR35 and the personal service company?

The legislation referred to as “IR35” is perhaps one of the least well understood areas of employment tax law. It is, however, a nettle that HR teams may soon need to grasp.

The mischief that IR35 was introduced to address back in 2000 was the practice of those who would otherwise have been employees providing their services to the “employer” through an intermediary. Typically, the intermediary would be a personal service company owned and controlled by the employee. Senior and skilled employees were attracted to these arrangements by the substantial income tax and national insurance savings that could be achieved.

In essence, IR35 is an anti-avoidance measure which (very broadly) asks whether the individual providing the services would have been an employee of the end user if it were not for the personal service company. If so, then the personal service company is required to operate PAYE and pay employer’s national insurance contributions.

IR35 has been tightened on a number of occasions in recent years to close perceived loopholes and in 2007 separate legislation was introduced to deal with commercial providers of so called “managed service companies”.

Having closed the loopholes, the Government believes that there is a growing body of evidence which suggests significant non-compliance with IR35 by the 265,000 personal companies that operate in the UK. As a result the Government has, in the last month, published a consultation paper which seeks views on options for reform.

The reason for the non-compliance is no doubt because the obligation to operate PAYE with the personal service company itself rather than the end user. This means that the arrangements are policed by those who benefit from them rather than by end users. End users are far more likely to take a conservative approach to compliance – mindful of the risk of substantial PAYE liabilities being uncovered by an HMRC PAYE investigation in years to come.

The Government does not believe that increasing compliance is sufficient and is consulting on “alternative options for more fundamental reform”. The options include requiring end users to determine whether IR35 should apply and, if so, for them to operate PAYE. If this option is pursued, as we believe likely, there will be a substantial job of work for HR teams to ensure that existing arrangements are fully compliant. Alternatively, to avoid the problem, many companies will simply require contractors to be directly

employed in the normal way.

If the obligation for compliance must be placed upon end users we would advocate a system whereby personal service companies (and directly engaged self employed contractors) are able to apply to HMRC for a “self employment certificate”. This can then be relied upon by end users who would need not then operate PAYE. This will allow legitimate personal service companies to continue to operate without penalising the end user.