

Use of consultants: how exposed are you under IR 35 or otherwise?

In the Budget on 29 October, the Chancellor announced fundamental changes to the tax rules that apply to consultants engaged through private companies (often referred to as IR 35). There was widespread speculation that the new rules would be implemented as early as April 2019, leaving organisations with little time to prepare for the changes.

Although the Chancellor has confirmed that these changes will now be delayed until April 2020 (and small organisations will be exempt), other important developments (such as the new offence of failure to prevent the facilitation of tax evasion) and the high level of complexity in correctly assessing a consultant's status for employment law and tax purposes mean that all organisations using consultants will need to review their existing arrangements, or risk potentially significant financial liabilities and even criminal liability.

[Click here](#) to jump to our checklist of practical steps you should be taking now to protect your organisation from these risks and the associated reputational damage.

1. What is the issue?

The use of consultants has become increasingly common in the modern job market. Increased scrutiny of these arrangements in recent years has indicated that many of the arrangements labelled as "consultancy" arrangements are actually more accurately categorised as employment relationships.

The correct categorisation of each individual's employment status is critical because it impacts on their employment rights and the correct taxation of payments made to them. Genuinely self-employed consultants do not benefit from the same rights as employees and workers (such as the right to paid holiday) and payments to consultants are not taxed in the same way as payments to employees.

Organisations can face potentially significant liabilities by incorrectly treating individuals as self-employed consultants rather than employees or workers.

The difficulty for organisations is that employment status is assessed on a case-by-case basis taking into account a range of different factors. The tests are not straightforward and in our experience the risk of an organisation applying the tests incorrectly is high.

Simply using a consultancy agreement to document the relationship will not be sufficient to make the individual a consultant as the courts and HMRC look behind the documentation to the substance of the arrangement.

The other challenge for organisations is that employment status is not static. An individual who was correctly categorised as a consultant last year may now be an employee or worker. As compliance is an ongoing matter, constant monitoring is required and organisations **need to know what steps to take and when** in order to manage their exposure.

2. What are the risks for your organisation?

Financial exposure

There are potentially significant financial liabilities for organisations that miscategorise individuals as consultants when they are actually employees or workers.

In one case last year, an individual who had been engaged under a consultancy agreement (and who even turned down an employment contract so that he could remain a “consultant”) was awarded 13 (yes, 13!) years’ worth of backdated holiday pay on the termination of the arrangement by successfully claiming that he had been a worker and was therefore entitled to paid annual leave.

Then there is the risk of HMRC seeking to recover unpaid PAYE deductions (plus interest and penalties) in respect of any individual who is engaged directly by the organisation and is deemed to be an employee or worker rather than a genuinely self-employed consultant.

For organisations that engage consultants through a personal service company, IR35 currently provides the end client with a level of “insulation” from such tax liabilities. However, recent developments mean that even where an organisation engages consultants through a personal service company, as the end client it needs to take a much keener interest in the individual’s employment status.

New “off payroll working rules” have already been introduced into the public sector and the Government has announced plans to introduce similar rules for businesses in the private sector from April 2020. These changes will fundamentally change the operation of IR35 by making the end client responsible for assessing a consultant’s employment status and applying the correct PAYE withholding. There will be an exemption for small organisations, but we will need to wait for the detailed provisions of the Finance Bill 2019-20 to see which organisations can benefit from this.

Government research indicates that only 10% of individuals providing services through a personal service company are applying the current IR35 rules correctly. This suggests that, under the new rules, there will be enormous scope for end clients to face significant liabilities if they continue to pay consultants without any deductions.

Criminal liabilities

Even before changes to IR35 shift responsibility for applying PAYE withholding to the end client, the corporate offence of “failure to prevent the facilitation of tax evasion” could extend liability to end clients in cases where an individual/their personal service company does not accurately assess their deemed employment status under the IR35 rules.

End clients will have a defence to this if they can show that they had “reasonable prevention procedures” in place to prevent the facilitation of tax evasion.

Organisations using consultants should review their current procedures now to satisfy themselves that they are sufficiently robust to establish this defence. If they are not, the organisation could face prosecution and an unlimited fine.

Increased scrutiny and reputational damage

A compliance failure in respect of an organisation’s consultancy arrangements could trigger increased scrutiny from HMRC in respect of its overall tax compliance and any publicity about an organisation’s non-compliance risks reputational damage. In an age where reputation is more important than ever, the consequences of such adverse publicity could easily exceed any direct financial liability.

3. What do you need to do now?

The increasing scrutiny and pace of change in this area means **organisations need to take action now to reduce their exposure**. Below is a checklist of the practical steps we recommend taking to help protect your organisation from the risks outlined above.

- **Carry out an audit of the consultant population.**
 - The first step is to identify potential risk areas by carrying out a critical review of existing consultancy arrangements to identify any that are at high risk of being deemed to be employment or worker relationships.
 - Organisations can do this internally by using the Government's free online "CEST" (Check Employment Status for Tax) tool or contact Fox Williams for support.
- **Analyse the results of the audit**
 - Identify high risk cases where action should be taken without delay.
 - Flag cases that require careful monitoring (e.g. where there are indications that employment status may change).
 - Identify improvements to contractual documentation and working practices to manage risks going forward.
- **Prepare an action plan**

The audit will help you prioritise the follow-up actions required to manage the organisation's exposure. Steps may include:

- Terminating high risk consultancy arrangements (which clearly needs to be handled carefully to minimise commercial and legal risks).
- Taking steps to "break the chain" of accrued employment liabilities where former consultants are re-engaged as employees.
- Putting in place arrangements to monitor and assess employment status on an ongoing basis.
- Ensuring the organisation has reasonable procedures, including due diligence processes, reporting procedures and staff training, to protect it against liability for facilitation of tax evasion by its consultants.
- Reviewing and (where necessary) improving the organisation's contractual documentation to protect the organisation's interests.

Our team of specialists is standing by to support you in implementing the steps set out in our checklist. Please contact **Emma Bailey**, **Helen Farr** or your usual Fox Williams contact now.



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