KENECT RECRUITMENT — REPORT

IR35 Announcement

Introduction

Did you know!?... Prior to the 2008 financial crisis, most agency workers were employed as PAYE workers... The ensuing recession hit the logistics sector hard, with agency requirements halving almost overnight. Hauliers, under extreme pressure to reduce their own margins, passed this onto agencies, relentlessly forcing down agency charge rates.

The agencies responded by putting pressure on driver pay rates, who in turn resorted to creative tax avoidance methods to maintain or even increase their take-home income. Lower paid workers, van, 7.5 tonne, adopted the Sole Trader model while higher paid workers, mainly LGV2 (rigid) and LGV1 (articulated) lorry drivers, opted for the Limited Company (aka the Personal Service Company, "PSC") model. The PSC model provides greater tax relief per pound earned but has higher fixed costs. The Sole Trader model, although less tax efficient, has lower fixed costs making it the better choice for incomes under £25k. HMRC has been working to put an end to these schemes and has implemented a sequence of six phases designed to eliminate agency tax avoidance, culminating in the final phase: the application of the new IR35 legislation to the Private Sector. The proposed changes place the onus for determining IR35 status of the drivers with the end Hirer now, and not with the individual PSC.

In mid-2019 the Government stated its intention to proceed with the roll-out of its IR35 legislation to the Private Sector in April 2020. In December, Sajid Javid announced that the decision would be "reviewed".

It is important to appreciate that the "review" will not necessarily result in a delay or cancellation of the planned changes, and that we must continue, on the basis that the roll-out will still go ahead in April 2020.

By permitting the use of Ltd Companies (Personal Service Companies) by agency workers for tax avoidance purposes, the government has effectively subsidised agency labour costs by around 20% over the last decade — making agency workers disproportionately cheap compared to full-time employees.

This has especially affected blue-collar workers earning between £25,000 - £40,000 per annum, as the cost of agency workers in this bracket has dropped below the cost of employing them full-time. These savings on direct employment costs, alongside lower

Industrial and Human Relations administration and reduced reputation risks, has led to employers replacing their full-time staff with agency workers. Larger employers have outsourced not only the variable element of their workforce but also their "standard operations", while the agencies they use have taken on a large quantity of stable work.

In turn, these large-volume agencies have been able to drop their margins by up to 10% by subsidising their variable work with the revenue gained from this easier, repetitive & stable work. This has further reduced the labour cost, per worker, to the end client.

IR35 will effectively raise agency labour costs by up to 25%, which will raise the cost to the end client by around 20%.

This hike in costs means employers who have outsourced their standard operations to agencies will reconsider their agency policy and, most likely, bring their "standard operations" labour needs back in-house — reducing their agency workforce to just what's needed to cover variability. Large-volume agencies affected by these worker movements will retain most of their costs, but for a much-reduced and more variable revenue base, so they'll have to increase their margins. We estimate this could be by up to an additional 10% of revenues, bringing them back into line with the majority of small to medium sized agencies.

The result? Professional blue-collar agencies will be forced to raise their charge rates by up to 20% and large volume agencies by up to 30%. This effectively constitutes a government tax on Private Enterprises with none of this extra cost benefitting the workers or agencies. We expect to see reduced numbers of agency LGV drivers, with large volume, low-margin agencies returning to the traditional model of catering for clients' variable and seasonal requirements, but at a higher margin. We also expect most professional blue-collar agency workers will migrate to PAYE, resulting in a level playing field where ethical & specialist agencies can compete fairly, growing their market share by providing superior services.

Our key concern is that the regulators, HMRC and the government do not rigorously enforce the IR35 legislation, tempting all parties to exploit tax avoidance methods to suppress costs. We could find ourselves in a marketplace where the unethical and unscrupulous operators have a competitive advantage over professional, ethical agencies — ultimately damaging the entire sector and the haulage industry as a whole. The more strictly the legislation is enforced, the quicker the transition to a stable and fair marketplace, which will be beneficial to all of us.

So, What are the Changes?

Although these changes have not yet been certified (due to the upcoming budget). IR35 defines a list of criteria, used to determine a worker's employment status. Under the current rules for the Private Sector, the contractor is responsible for determining their own employment status and for paying the relevant tax and NI. If HMRC suspects that a contractor is avoiding tax through "false self-employment", i.e. by working as a Limited Company contractor, it has to pursue the Director of the company through court action to recover any underpaid taxes.

This is a laborious task for relatively little return, and HMRC doesn't have the resources to pursue such a large number of Ltd Company contractors, nor can it pursue a class action as each case is unique. The threat of HMRC action on falsely self-employed Ltd Company contractors has been so low, it's essentially been non-existent; unlawful Ltd Company workers continue to avoid tax with impunity.

This legislation makes it much easier for HMRC to take legal action against either the Fee Payer or the End Client, preventing tax avoidance through the incorrect use of Ltd Company arrangements. It also works on the basis that clients and agencies are generally risk-averse and will lean towards declaring their workers to be within IR35, rather than risk being pursued by HMRC along with the associated reputation risks. This results in a tendency towards "false employment".

Another key element of the legislation is that "Small Businesses" will be exempt from the IR35 legislation when it is applied to the Private Sector.

A Small Business is defined as a company which satisfies two or more of the following requirements:

- **Has an aggregate net turnover less than £10.2 million**
- **Has fewer than 50 employees**
- **Has an aggregate balance sheet total less than £5.1 million**

It might seem like this excludes a large number of companies, but when you consider that larger companies use the majority of agency workers, it becomes apparent that most agency workers will be affected by the IR35 legislation.

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Are you a Limited Company Worker?

New changes to the Government's IR35 legislation will come into force in April 2020, preventing larger haulage companies from taking on drivers who work as Ltd Companies. Instead, you'll need to be employed as a PAYE worker - either as part of a haulage company's permanent driver pool or on your agency's payroll. You'll still be able to work through your agency's Umbrella scheme as a PAYE worker.

Why IR35 Affects You

There are several criteria you must meet to legally continue trading as a Ltd Company contractor. We've listed four of these criteria below to help you understand why, as an agency driver, you fall under IR35 and will likely need to move to a PAYE model. Kenect Recruitment works with an accredited and compliant payroll company called FLO Outsourcing. Options going forward are limited to Umbrella, or PAYE . Which could reduce take home pay down by as much £75 week on average. So at Kenect we have teamed up with our payroll partner to offer a unique MyWorkCoop model to help increase take home pay. If you would like to know more about this please contact us on 0844 329 0001.

We're Working for You!

Our team is working really hard to negotiate new and improved PAYE rates with our clients so that we can offer our PAYE drivers the same level of net (after tax) pay they would get operating as Ltd Company contractors. If you have any questions or would like to discuss the changes in more detail, we're more than happy to talk you through the options and, where applicable, guide you through the steps to transfer over to PAYE.