

Effects of the off-payroll working reforms on agencies

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1 Glossary

Term	Definition
Check Employment Status for Tax (CEST) tool	A HMRC online digital tool to assist employers, clients, agencies and workers in determining the employment status for tax of a worker.
Contractor	An individual who contracts to perform work at a certain price or rate. These individuals can be engaged in different ways. For example, through their own limited company, as a sole trader/self-employed individual, as an agency worker on the agency's payroll, or as an employee of an agency or umbrella.
Employment agency	Used here to refer to an organisation which supplies contractors to clients.
IR35 (off-payroll working rules)	IR35 is how the off-payroll working rules are commonly known. They are the rules introduced to ensure individuals who work through their own limited company or other intermediary pay similar levels of Income Tax and National Insurance contributions (NICs) as individuals who are directly employed.
Pay As You Earn (PAYE)	PAYE is HMRC's system to collect Income Tax and National Insurance contributions from employment.
Personal service company (PSC)	A limited company through which the worker supplies their services. Typically, the worker controls and has some interest in their PSC.
Umbrella	There is no statutory definition of an 'umbrella' company, although it is generally accepted that an umbrella company is a company that employs temporary workers (contractors) who work at different clients' premises. Umbrella companies do not source work. Typically, they will enter into a contract with a recruitment agency that will source work from clients.

2 Executive Summary

Introduction

The off-payroll working rules (commonly known as IR35) were introduced in 2000. This legislation was introduced to ensure individuals working like employees but through their own limited company (often known as a personal service company or 'PSC') or other intermediary pay broadly the same amounts of Income Tax and National Insurance contributions (NICs) as individuals who are directly employed.

To mitigate against non-compliance, a reform was introduced in 2017 in the public sector only, which transferred the responsibility for considering the rules and determining a contractor's employment status for tax from the contractor's PSC to the client. Furthermore, where contractors were deemed to be inside the off-payroll working rules, the client or agency that directly pays the contractor's PSC became responsible for deducting the relevant Income Tax and NICs.

The Government intended to extend this reform to medium and large-sized non-public sector organisations in April 2020. However, as part of the Government's COVID-19 economic response package, the reform was delayed until 6 April 2021.

It is in the context of the 2017 reform and the upcoming 2021 reform that HMRC commissioned IFF Research to explore the effects the reforms have and may have on employment agencies. The research aims to understand:

- The effects of the 2017 off-payroll working reform on employment agencies, and to provide insights into how contractors may have been impacted.
- What further support agencies might need from HMRC on the off-payroll working rules ahead of the changes in April 2021.
- The early effects of the 2021 reform.

To answer these research aims, between November 2020 and January 2021 IFF Research conducted qualitative interviews with 34 employment agencies that currently or previously had contractors on their books that work through their own personal service companies (PSC) or another intermediary.

The effects of the 2017 off-payroll working reform

Twelve agencies that work with clients in the public sector participated in an interview as part of this research. Of these, many reported that the number of contractors they have on their books, across all structures of engagement, remained stable or increased since the introduction of the 2017 reform to the off-payroll working rules.¹ Where changes were seen, these were not always a direct result of the 2017 reform. Where there was an increase, this was often attributed to wider business development and growth, particularly among private sector clients.

Some agencies reported a decrease in the number of contractors on their books since 2017. Where this was the case, it was more common for this decrease to be attributed to external factors rather than the 2017 reform, particularly the UK's exit from the EU and the COVID-19 pandemic. Some

¹ This includes contractors that work through their own limited company (PSC), as a sole trader/self-employed individual, as an agency worker on the agency's payroll, or as an employee of an agency or umbrella.

attributed the decrease to the 2017 reform, reporting that it had reduced the supply of and demand for contractors.

Agencies noted that many contractors had shifted away from PSCs towards alternative methods of engagement because of the 2017 reform, specifically towards the payroll of agencies and umbrella companies. A few agencies said that the 2017 reform had little effect on the arrangements used by contractors. This was because these agencies had tended not to engage contractors that used PSCs prior to the introduction of the reform.

Some agencies reported that the rates paid to contractors that worked through PSCs in the public sector increased after the 2017 reform. This was because contractors had demanded higher gross pay from clients to cover the reductions in their net pay from tax and NICs deductions. Some agencies said that contractor rates stayed the same. This was due to a variety of reasons, including contractors being engaged through the agencies' payrolls and rates being set by other legislation.

Many agencies made changes to their internal processes in response to the 2017 reform. These included: introducing payroll systems, introducing new compliance checks, and making arrangements with umbrella companies. Some agencies reported that these changes had increased the administrative burden around managing and placing contractors. A few agencies emphasised that there had been a significant increase in the work around managing and placing contractors that work through PSCs.

Support needed by employment agencies ahead of the 2021 reform

All agencies had taken steps to prepare for the 2021 reform. The most common preparations reported by agencies were attending training, conducting internal research, and engaging in conversations with clients and contractors about the reform. Some agencies had also implemented new processes to ensure their compliance with the legislation, whilst others had spent time checking employment status determinations of contractors currently on their books.

Most agencies had used HMRC guidance and support to inform their preparations for the reform. This included online HMRC guidance documents and HMRC webinars. In some cases, agencies had sought support from trade bodies, and a few agencies reported hiring external advisors and consultants to deliver guidance and support.

Some agencies reported that the support and guidance available from HMRC had been helpful in enabling them to prepare for the reform, ahead of the intended introduction in April 2020. They therefore did not see requirement for any additional support or guidance from HMRC. This was most evident among agencies that had already been affected by the 2017 reform.

However, other agencies felt that HMRC support and guidance around the reform could be improved. The main area for improvement suggested by agencies was to simplify the wording used to help provide clarity on what the reform meant in practice. Other areas of improvement mentioned included making it easier to contact HMRC and for HMRC to offer support and guidance through alternative channels. There was also feedback surrounding agencies' perceptions over how reliable and accurate the Check Employment Status for Tax (CEST) tool was, with some calling for improvements to be made.

Some agencies felt that HMRC should seek to provide more support and guidance tailored to contractors and clients to ensure that they are aware of the changes and the options available to them after April 2021.

It should be noted that the findings presented in this report reflect the support needs of agencies within a specific timeframe. Interviews were conducted between November 2020 and January 2021.

Views of agencies on the early effects of the 2021 reform

For most agencies there had been no impact as a direct result of the April 2021 reform at the time of interview and the early effects reported below were not mentioned by many agencies.

Some agencies reported early signs of contractor numbers decreasing in the lead up to April 2021 and had seen a similar trend in the run up to the initial date set for the introduction of the reform (April 2020). This was caused by a reduction in the number of contractors using PSC arrangements. These agencies typically attributed the decrease in the number of contractors using PSCs to the perceived effect of the reform on the supply of contractors. A few agencies also reported early signs of client demand for PSC contractors reducing ahead of April 2021.

Some agencies had seen the number of contractors using PSCs decline and this had typically been driven by the actions of agencies and their clients. Some agencies and clients had notified contractors about the reform and the way they intend to operate thereafter, motivating some contractors to change their arrangements in preparation. Other agencies and clients had drawn a *'line in the sand'*, i.e. stopped using PSCs, resulting in the number of contractors using PSCs on their books to reduce. A couple of agencies emphasised that the decline in the number of contractors using PSCs was not just a consequence of the reform, but also influenced by other factors (e.g. the current economic climate).

The agencies that had seen the number of contractors using PSCs decrease in the lead up to April 2021 reported that many of these contractors had closed their PSC and moved over to one of two alternative arrangements: 1) working on the payroll of agencies and 2) working through umbrella companies.

There were very few observed effects on contractor rates at the time of interview as a direct impact of the 2021 reform. In a few cases, agencies had seen indications that rates were increasing, primarily because contractors were putting pressure on agencies and clients to increase their gross pay. This was done in an attempt to offset the reduction in their net pay from Income Tax and NICs deductions as well as other charges, such as umbrella company admin fees, after transitioning to alternative structures of engagement.

Many agencies had implemented changes to their systems and processes in preparation for the reform. The nature and the scale of the changes made by agencies varied depending on the way they operated prior to the introduction of the reform and how they intended to operate once the reform comes into effect. Those with no prior involvement with the off-payroll working rules and those with limited options in terms of alternative methods of engagement were required to make more significant changes than their counterparts. Consequently, the changes to their systems and processes were more significant and therefore more time consuming and costly.

3 Introduction

Background and objectives

The off-payroll working rules were introduced in 2000. This legislation was introduced with the aim to ensure individuals working like employees but through their own limited company (often known as a personal service company) or other intermediary pay broadly the same Income Tax and National Insurance contributions (NICs) as individuals who are directly employed.

Initially, it was each contractor's PSC or other intermediary that was responsible for determining their employment status for tax under the off-payroll working rules and deducting the relevant taxes and NICs.² To mitigate against non-compliance, a reform was introduced in 2017 in the public sector only, which transferred the responsibility for considering the off-payroll working rules and determining a contractor's employment status for tax from the contractor's PSC to the client. Furthermore, where contractors were deemed to be inside the off-payroll working rules, the client or agency that directly pays the contractor's PSC became responsible for deducting the relevant Income Tax and NICs.

The Government intended to extend this reform to medium and large-sized non-public sector clients in April 2020. However, as part of the Government's COVID-19 economic response package, this reform was delayed until 6 April 2021.

It is in the context of the 2017 reform and the upcoming 2021 reform that HMRC commissioned IFF Research to explore the effects that the reforms have had and may have on employment agencies.³

The aim of this research was to better understand:

- The effects of the 2017 off-payroll working reform on employment agencies and to provide insights into how contractors may have been impacted.
- What further support agencies might need from HMRC on the off-payroll working rules ahead of the changes in April 2021.
- The early effects of the 2021 reform.

Methodology

Between November 2020 and January 2021, IFF Research conducted qualitative interviews with 34 employment agencies. Most of these agencies had contractors on their books that worked through their own personal service company (PSC) or other intermediary at the time of the interview (32). A couple of agencies did not have contractors that worked through a PSC or other intermediary on their books at the time the interview took place, but they had in the past. One agency had contractors working through PSCs or intermediaries up until 2017 but then stopped because of the 2017 reform, and one agency had contractors working through PSCs or intermediaries since 2017 but did not at the time of the interview.

² In the context of this policy and research area, these companies are known as 'personal service companies' or PSCs.

³ HMRC have also commissioned research with public sector organisations to explore the long-term effects of the 2017 reform. This project has been temporarily paused due to the COVID-19 pandemic, however an interim report on education sites only has been published in the meantime.

Agencies were recruited for qualitative interviews by IFF Research's in-house recruitment team. The contact details for employment agencies were obtained from one of two sources: a random sample of employment agencies drawn from HMRC databases and a free-found sample built by IFF Research.

All qualitative interviews were conducted remotely, either by telephone or video call (e.g. via Microsoft Teams). Due to fieldwork taking place during the COVID-19 pandemic, it was not possible to conduct qualitative interviews face-to-face. The need to conduct interviews by telephone and video call did not impact on the ability to meet the research aims. On average, each interview lasted 60 minutes.

When interpreting the data in this report it should be noted that qualitative research provides insight into perceptions, feelings, and behaviours rather than quantifiable findings that can produce statistical conclusions. Quantifiable or statistical conclusions should not be interpreted from these findings due to the small sample size used.

The profile of participating agencies

Interviews were conducted with a wide variety of agencies. For example, in terms of size, client base, and industry specialism.

Size

Participant agencies ranged in terms of the total number of contractors on their books, from those with fewer than 50 to those with over 500 (see Table 3.1). Two agencies reported having in excess of 1,000 contractors.

Table 3.1 Participating agencies by total number of contractors working through all structures

Number of contractors	Number of interviews
Fewer than 50	14
Between 50 and 99	8
Between 100 and 499	7
500 or more	5
Total	34

Client base

As shown in Table 3.2, interviews were conducted with agencies that worked with private sector clients and agencies that worked with clients in both the private sector and public sector.

No agencies that worked exclusively with public sector clients were interviewed. This is because agencies in the sample sources overwhelmingly supplied contractors to public and private sector clients or just private sector clients. Where agencies that only worked with public sector clients featured in the sample sources available, all reported that they had never had contractors on their books that work through their own PSC or other intermediary. They were therefore not eligible for this research.

Table 3.2 Participating agencies by sector

Client sector	Number of interviews
Private sector clients only	22
Public and private sector clients	12
Total	34

Industry specialism

Table 3.3 presents the range of industries that agencies supplied contractors to. In some cases, agencies worked across multiple industries.⁴

Table 3.3 Participating agencies by industry

Industry	Number of agencies
Healthcare	8
Engineering/construction	6
IT/marketing	6
Transport/logistics	5
Financial services	4
Manufacturing	3
Technical/scientific services	3
Education	2
Hospitality/retail	2

Labour Supply Chains

Most agencies worked directly with clients and contractors (or the contractor’s PSC or other intermediary), with no other agencies involved in the process of placing contractors in assignments. A few agencies, particularly those involved in large-scale construction and engineering projects, reported occasionally working with other agencies; however, this was an infrequent occurrence.

⁴ Table 3.3 presents the number of agencies that supplied contractors to each industry. Where agencies worked across multiple industries, they are counted more than once.

Some agencies had an international element to their supply chain. Five agencies supplied contractors that worked through PSCs or other intermediaries to clients based overseas (three private sector only and two private and public sector). Of these, three also reported having contractors that worked through PSCs or other intermediaries that were based overseas (all private sector only). There were no discernible differences between agencies that had an international element to their supply chain and those that did not in terms of their experiences of the 2017 reform and expectations for the 2021 reform.

4 Effects of the 2017 reform

This chapter explains what effects the 2017 reform to the off-payroll working rules has had on the twelve employment agencies that work for clients in the public sector. Specifically, the chapter covers the effects of the reform on the number of contractors agencies had on their books; the methods of engagement used by contractors; the rates paid to contractors; and the systems and processes used by agencies.

Effects on the total number of contractors across all structures

Many agencies reported that the number of contractors they have on their books, across all engagement structures, has remained stable or increased since 2017. Where changes were seen, these were not always a direct result of the 2017 reform. Where there was an increase, this was often attributed to business development and growth, particularly among private sector clients. Where contractor numbers remained stable, agencies commonly attributed this to the profile of their client base or their business model helping them retain contractors. All agencies supplied contractors across both sectors, and some emphasized that the freedom to choose between public sector and private sector assignments motivated contractors that worked through PSCs to remain with the agency. In addition, some agencies that had alternative engagement structures to PSCs available said that contractors and clients shifted over to different methods of engagement (e.g. agency payroll and umbrella companies) with minimal churn.

"[The number of contractors has] increased because of natural growth of the business... year on year we have just got busier, and it has been growth that has been natural in each sector"

Private and public sector, 50–99 contractors

"The number of contractors is very similar – one less in October 2020 than in March 2017... people were forced to take either umbrella or PAYE options"

Private and public sector, 100+ contractors

Where agencies reported a decrease in the number of contractors since 2017, it was more common for this to be attributed to external factors rather than the 2017 reform to the off-payroll working rules. For example, some agencies highlighted how the UK's exit from the EU and the COVID-19 pandemic had reduced the availability of work, which in turn impacted contractor numbers. For example, due to the COVID-19 pandemic, there were a number of delayed or cancelled projects within the construction sector. Furthermore, some agencies suggested that the UK's exit from the EU had resulted in workers leaving the UK, particularly in the transport and the healthcare sectors.

"Clearly COVID has turned everything upside down everywhere... prior to that, due to the uncertainty around Brexit and a Government that didn't have a clear majority, the business environment was a pretty uncertain one. So, there was an awful lot of cautiousness and we saw a lot of projects stopping or pausing or anticipated projects were delayed"

Private sector, fewer than 50 contractors

Some agencies linked the decrease in the number of contractors on their books since 2017 directly to the 2017 reform to off-payroll working rules. They mentioned that they lost contractors due to a combination of a reduction in demand from public sector clients and a reduction in supply. Some public sector clients had decided to offer permanent employment contracts rather than use contractors to avoid the work associated with the off-payroll working rules and the risk of making incorrect employment status determinations. A few said that the downward effect the reform had on

PSC contractor net pay had caused some contractors that used PSCs to cease operating as a contractor altogether, and instead take permanent employment contracts. Furthermore, a couple of agencies mentioned losing contractors that previously worked through PSCs to other agencies that offered the option of working through umbrella companies. As a consequence of losing clients and contractors to the reform, some agencies were required to reprioritise and grow their business in the private sector.

The agency quoted below supplied contractors to clients in the healthcare industry, both in the private sector and the public sector. In their experience, after the introduction of the 2017 reform, contractors had left to work for healthcare organisations full-time or had left to work through other agencies that offered the option to work through an umbrella company.

"It affected our capability to supply healthcare staff to the NHS... [Contractors] didn't want the extra taxation; they didn't want the bother and a lot of the people who worked through their limited companies felt it was a direct attack on them and their ability to earn money. A lot of them responded by not working for agencies."

Private and public sector, 100+ contractors

Effects on methods of engagement

Agencies noted that many contractors had shifted away from PSCs towards alternative methods of engagement because of the 2017 reform, specifically towards working on the payroll of agencies and working through umbrella companies.

"The number of contractors that use PSCs has decreased... It has been a direct consequence of the 2017 reforms as people are forced to take either umbrella or PAYE options for their income"

Private and public sector, 50–99 contractors

Working through the payroll of agencies or through umbrella companies was viewed by clients and contractors as a way to reduce exposure to the off-payroll working rules, and a way to reduce the administrative work associated with the reform, as well as carrying other advantages. For example, using contractors engaged through agency payroll meant that clients did not need to issue status determination statements and offered greater security and benefits to contractors. Similarly, umbrella companies would be responsible for tax deductions while allowing contractors to maintain independence, claim tax relief on expenses and consolidate multiple incomes into one organisation.

"We were having people transferring from their limited companies to PAYE... Some people were glad to get off of it... it might be [easier] but only if you keep your receipts and do your invoices and get your returns in on time... you see people go down the PSC route because they've just seen the higher hourly rate and then regret it once they see the admin side of things."

Private and public sector, 100+ contractors

Some agencies mentioned negative outcomes associated with alternative engagement methods. A few had difficulties attracting contractors onto their payroll because, compared to working through a PSC, their net pay was lower. There was also scepticism around deals for contractors offered by umbrella companies. One agency went as far as discouraging contractors from using umbrella companies as some contractors were thought to have been misled by the offer of higher hourly rates, only to find these were accompanied by admin fees.

“The reason why workers choose umbrella companies is because it looks as though they are getting a higher hourly rate i.e. £8.72 from PAYE vs £10.15 from an umbrella. However, they do not understand that the worker does not get the full £10.15 once the umbrella has been paid and rate broken down.”

Private and public sector, 100+ contractors

A few agencies said that the 2017 reform had little effect on the arrangements used by contractors. This was because these agencies tended to not engage contractors working through PSCs for public sector assignments prior to the introduction of the 2017 reform.

“The 2017 reforms have had little impact on us because our contractors working in the public sector have always been engaged as PAYE [since 1998].”

Private and public sector, 100+ contractors

Effects on contractor rates

Some agencies reported that the rates paid to contractors in the public sector increased after the 2017 reform. This was said to be because contractors with PSCs had demanded higher gross pay from clients to cover the reduction in their net pay from the deduction of Income Tax and NICs. Furthermore, as the reform was only applied to the public sector, it introduced a differential in the pay rates offered by public and by private sector clients. This meant contractors, including those working through arrangements other than PSCs, could leverage public sector clients for higher rates because they were available in the private sector. Public sector clients subsequently yielded to the pressure from contractors to increase rates. This was most prominent in the IT sector and healthcare sector. A couple of agencies mentioned their clients had struggled to afford the increased rates required to remain competitive.

“Rates increased for clients because there was a supply and demand issue. Contractors could choose whether to work within the public or private sector.”

Private and public sector, fewer than 50 contractors

“There has been upward pressure on public sector end-clients for pay rates to be higher for contractors, to factor in the NI and tax deductions that are inevitable.”

Private and public sector, 100+ contractors

Some agencies said that contractor rates had not increased as a consequence of the 2017 reform. This was due to a variety of reasons, including contractors not being impacted by the off-payroll working rules because they were already engaged through the agency's payroll prior to the reform, rates being set by legislation (e.g. NHS frameworks and the National Minimum Wage), and generally being able to fill roles regardless of contractors receiving lower net pay.

“You would think that would impact on the ability to appoint somebody [lower net pay], to attract someone to that role, but not really. Where we have had to convert, they have recognised the writing on the wall and they have to accept the lower rate. The impact lies with them not us. We still try and make our margin.”

Private and public sector, 100+ contractors

Effects on employment agency processes

Many agencies with public sector clients were required to make changes to their internal processes in response to the 2017 reform. These included: introducing payroll systems, introducing new compliance checks, and making arrangements with umbrella companies.

“There was a change in our contracts to ensure clients were aware of their obligations for additional costs and risks involved should a status determination not be delivered to us or be changed.”

Private and public sector, 100+ contractors

“We have such different types of supply, designed to work for people going in for a number of weeks where there was a decent run-up to the role being filled, so that we could get communications and have assessments back in time to advertise and so that the worker would understand the options available to them, the recruiter would have time to store the assessments and put everything in place.”

Private and public sector, 100+ contractors

Some agencies reported that the changes made to their processes increased the administrative burden around placing contractors. Creating and updating contracts, implementing processes to ensure clients were compliant and having contractors on their internal payroll all increased admin on an ongoing basis. A few agencies emphasised that there had been a significant increase in the work around managing and placing contractors with PSCs.

“We had to build a system into our recruitment database that would force compliance to make sure that things flowed through properly and there was a considerable cost to that.”

Private and public sector, 100+ contractors

Where agencies had made no changes after the introduction of the 2017 reform, this was because they already operated in a way that helped them adapt to the off-payroll working rules in the public sector. For instance, some already offered alternatives to PSCs. For the agencies that already engaged most contractors through their own payroll, shifting contractors that used PSCs onto this system was perceived as a better application of internal resource, compared to creating new systems required for the off-payroll working rules.

5 Awareness and understanding of the 2021 reform

This chapter begins by covering employment agencies' awareness and understanding of the 2021 reform to the off-payroll working rules, before moving on to address the extent to which agencies felt clients and contractors were aware of and understood the reform.

It should be noted that the findings presented in this chapter reflect levels of awareness and understanding within a specific timeframe. Interviews were conducted between November 2020 and January 2021.

Employment agencies' awareness and understanding

All agencies were aware of the reform coming into effect on 6 April 2021, with most reporting that they became aware of it in advance of the original date set for its introduction.⁵ Furthermore, most agencies reported that they had a good understanding of the changes to the rules and what they meant in terms of the way they operate, and the way other parts of their labour supply chain operate. A few agencies that worked in the public sector commented that the 2021 reform was easier to understand than the 2017 reform due to improvements made in HMRC guidance and support.

"The reforms are easy to understand and everyone should know they're coming up."

Private sector, fewer than 50 contractors

"The documentation and guidance that we read was pretty clear at explaining where you sat in the responsibility chain and so on. I thought that was much better than the initial phase... there was not a lot of ambiguity about what we thought we needed to do."

Private and public sector, 50–99 contractors

"I think this time it will probably be clearer, it's pretty much every role within our sector what would be in scope... That makes it easier to explain to people this time."

Private and public sector, 100+ contractors

Although most agencies had a good understanding of the reform, a few reported having difficulties understanding certain elements of the changes. These agencies understood the basic principles of the reform but reported confusion around elements like employment status determinations, whose responsibility and liability it was for conducting determinations, and which organisation in the labour supply chain fulfils the role of the 'fee-payer'. Those reporting uncertainty around the upcoming reform tended to be smaller agencies with no prior involvement with the off-payroll working rules.

"It's the deeming of whether someone falls inside or outside, and I think there is a lot of confusion, especially with the clients, about do they decide, does the agency decide or does the contractor decide?... between us and the clients the question is where does the onus lie on this and who is the fee-payer?... I'm on quite a lot of pay-roll groups, accountancy groups and student forums and stuff like that and I've never met a person that understands IR35 fully."

Private sector, 50–99 contractors

"The thing that still puzzles me to this day is whether you're inside or outside IR35. I still find that a difficult question to answer."

Private sector, fewer than 50 contractors

⁵ April 2020.

Clients' awareness and understanding

Many agencies were confident that their clients were aware of the 2021 reform. This was often because they had spent time communicating with their client base as part of their preparations, with many having publicised the reform and conducted meetings with clients in the lead up to April 2020.

"Part of the preparation has been educating our clients and preparing them for a change in circumstances."

Private and public sector, fewer than 50 contractors

"We're instructing any clients that are medium or large that where they have a placement through a limited company, we are going to convert them to PAYE after 6th April, should they want to continue... everybody is aware"

Private and public sector, 50 to 99 contractors

Although many agencies were assured that clients were aware of the upcoming reform, some noted having clients that did not appear to have fully engaged with it yet. It was felt that some clients were putting off getting involved with the reform and the associated changes to their processes until the "eleventh hour". A few agencies reported that the delay in the introduction of the reform had meant that some clients were not taking the reform seriously and ignoring it as they felt it would be unlikely to come into effect in April 2021. In short, they anticipated another delay.

"As we got closer and closer to the date and got legal updates and updates from the various recruitment associations saying this is going ahead, there was still an element of 'no this isn't really going to happen'."

Private sector, fewer than 50 contractors

In terms of the extent to which agencies thought their client base understood the reform, many felt their clients typically had a good grasp of the changes and so had prepared for them. For example, making plans to transition from using contractors through PSCs to using contractors on the payroll of agencies.

However, some agencies gave accounts of clients having a poor understanding of the reform. These clients were often said to have misunderstandings around which types of assignments were inside the off-payroll working rules and which were outside. Consequently, agencies have had to spend time liaising with these clients to explain the rules and how to apply them.

"People don't understand it. I've been working with this since early last year and I still get questions. I keep having conversations with different organisations and they're saying, 'If the contractor operated in this way it would put them outside of IR35'."

Private sector, 100+ contractors

Contractors' awareness and understanding

As they had with clients, many agencies had spent time notifying contractors about the 2021 reform and discussing what the implications are for them. Consequently, many were assured that contractors were aware of, and understood, the reform. Some commented that this was evidenced by the changes some contractors had made to working arrangements in the run up to April 2020.

"The contractors know what's coming. Most of the contractors we deal with are professional contractors. They've been contractors for many years, and they know what it means."

Private sector, fewer than 50 contractors

"Most of them are taking it on board. Most people do realise it is going to be happening."

Private sector, 100+ contractors

However, some agencies highlighted experiences where they had issues with contractor awareness and understanding. For example, some agencies mentioned incidents where they had spoken with contractors who had no awareness of the reform. Meanwhile, some agencies had experienced disputes with contractors over employment status determinations and their plans for engagement options after April 2021, which they often attributed to a lack of understanding. A few agencies commented that some contractors were not taking the reform "seriously" because they did not expect it to be introduced.

"If I was completely honest, half of them probably don't have a clue that this is coming in. I spoke to one yesterday who is PAYE and she sent me a message to say she's in the process of setting up her own limited company!... I rang her to have a bit of a chat and I said 'are you aware that IR35 is coming in?' and she said she had spoken to an accountant and set up the business and not one person had mentioned IR35 to her."

Private sector, 50 to 99 contractors

"At the time there seemed to be a lot of press about it and information. And as time goes on, what with it being delayed, we're finding it harder to get our point across to workers because they think we're in another lock down, they can't introduce it, it will be deferred again... the problem we've got is people taking us seriously after its been deferred."

Private and public sector, 100+ contractors

6 Preparations for the 2021 reform

This chapter covers the preparations made by employment agencies ahead of the introduction of the 2021 reform to the off-payroll working rules. In addition to addressing the types of preparations made, it also explores the guidance and support used to inform preparations and any further guidance and support agencies would like from HMRC.

It should be noted that the findings presented in this chapter reflect the preparations made by agencies and their support needs within a specific timeframe. Interviews were conducted between November 2020 and January 2021.

Preparations made by employment agencies

All agencies had taken steps to prepare for the reform, with many having prepared in the run up to April 2020, before the postponement. The most common actions reported by agencies were attending training, conducting internal research, and engaging in conversations with clients and contractors about the reform. Some agencies also reported implementing new processes to ensure their compliance with new legislation, whilst others had also spent time assessing contractors currently on their books to ensure compliance.

The scale of preparations made by agencies varied depending on a few factors, including prior experience of the off-payroll working rules, the way in which agencies currently operate and the way in which they intend to operate after April 2021. For example, where agencies had prior experience of dealing with the off-payroll working rules, less time had been spent attending training and conducting research. Meanwhile, private-sector-only agencies that had no prior experience of dealing with the off-payroll working rules typically had to dedicate more time and resource to preparations.

Most agencies had conducted independent internal research, and many had taken part in webinars or external training courses to educate themselves on the upcoming reform. The resources and events were often hosted by HMRC, though in some cases had been obtained from relevant trade bodies (e.g. the National Federation of Self Employed & Small Businesses Limited (FSB) and the Recruitment and Employment Confederation (REC)). A few agencies reported hiring external advisors and consultants to assist in the preparations for the upcoming reform and to advise on the individual circumstances with contractors.

“Where we’ve had specific queries, we’ve gone to a third party [payroll system provider] to understand how their software will support the reforms.”

Private sector, fewer than 50 contractors

As illustrated in the previous chapter, many agencies had spent time communicating with clients and contractors about the reform. For example, through email newsletters and one-to-one meetings. Those engaging in conversations with clients aimed to inform them of their responsibility to make and share employment status determinations. Agencies engaging in conversations with contractors focused on raising awareness of the reform and explaining to contractors the options available to them after April 2021.

“It’s been a question of educating the client and the contractor and trying to provide them with a little bit of information and a bit of a leg up to help them make the changes to comply with the new legislation.”

Private sector, fewer than 50 contractors

“Our role is not to be boiler tight experts on this, it’s to be sufficiently knowledgeable to point both parties in the direction to keep them safe.”

Private sector, fewer than 50 contractors

Many agencies reported having updated or introduced new processes to prepare for the upcoming reform. For instance, some had updated or introduced a payroll system to allow for the anticipated increase in the number of contractors moving onto the agencies’ PAYE (as detailed in Chapter 7). Meanwhile, some agencies noted having spent time conducting background checks on umbrella companies and checking that they are accredited by the FCSA. In many cases agencies were not required to make changes because they had the alternative arrangements to PSCs in place already.

Some agencies reported having spent time assessing the arrangements of their current contractors to work out whether their arrangements needed to change before April 2021. To do this, many used HMRC’s Check Employment Status for Tax (CEST) tool, but some mentioned that they had introduced external (paid-for) tools to enable them to conduct employment status determinations and sought the advice from consultants to supplement determinations made by clients. Although the responsibility for providing employment status determinations will fall to the client, some agencies invested in tools because they want to be able check the determinations made by clients and to inform the advice they give to clients and contractors.

“We’ve ensured that we have an IR35 process that we can hopefully talk to our candidates and our clients about, that there is an online SDS system that’s fully insured, that we’ve invested in.”

Private sector, fewer than 50 contractors

“Some would argue the CEST tool is too binary, there’s lots of Yes–No answers, while [the external tool provider] would argue that their tool allows for more explanation and subtlety and is reviewed by a qualified assessor rather than an algorithm that punches out yes, no or inconclusive.”

Private and public sector, fewer than 50 contractors

“The feedback so far is that it wasn’t the best tool. I know there’s been improvements which have apparently helped it, but the advice we’re being given is very much to use it in conjunction with experts to make sure we’re doing the right thing.”

Private sector, 50-99 contractors

The investment in external tools and advice was partly motivated by some agencies having doubts about the usefulness of the CEST tool for assessing the employment status of contractors on their books. These doubts were also shared by agencies that only used the CEST tool. Therefore, despite enhancements made to the CEST tool in 2019, some agencies continue to hold the view that there are issues with the scope, clarity, and applicability of the tool.

Some agencies said that some of the questions in the CEST tool were too general and not tailored to all circumstances. For example, an agency that supplied contractors for professional and technical assignments said that questions around substitution and financial risk did not always capture the true arrangements of contractors, while an agency that supplied contractors to healthcare settings said that questions around control over work were generally not appropriate. Furthermore, a couple of agencies said that a lack of questions about mutuality of obligation in the CEST tool limited its usefulness. Some agencies also commented that some of the questions in the CEST tool were too open to interpretation. This resulted in occasional circumstances where contractors, agencies and clients have reached different conclusions about the employment status determination for the same assignment.

"I think for the likes of a building company where all their builders are contractors, I think yes it is useful for that. But I think a lot of these inconclusive results are coming from where gaps in the tool are, one of those specifically being nursing and care from a private point of view where you're picking up shifts here, there, and everywhere."

Private sector, 50–99 contractors

"With things like supervision, direction and control – can you come and go as you please? Do you have the right to substitute? The worker would say 'yes', but the client would say 'no, you can't really because I can't have someone substituted to cover you for a couple of days because you are that deep in this project'... The worker will generally get the answers that they want, and the hirer will get the opposite. They will interpret those questions differently."

Private and public sector, 100+ contractors

Employment agencies' support needs

Most agencies reported having used some form of support or guidance from HMRC to educate themselves around the off-payroll working rules, although agencies had varied opinions in terms of its usefulness. Some agencies reported that the support and guidance available from HMRC had been helpful in enabling them to prepare for the reform in the run up to April 2020. They therefore did not see a requirement for any additional support or guidance from HMRC. These agencies tended to be larger organisations or those that had prior experience of working with the off-payroll working rules within the public sector, though these opinions were not exclusive to this type of agency.

"No advice needed from HMRC for the reforms. We will speak to them as and when we need to."

Private and public sector, 100+ contractors

"We've always found what we needed from HMRC, that along with the documentation supplied by APSCO has pretty much seen us through. We've never felt we couldn't find out what we needed."⁶

Private and public sector, 50–99 contractors

However, other agencies felt that HMRC support and guidance around the off-payroll working rules could be improved. Some mentioned that the information provided on the website was unhelpful and, in some cases, caused further confusion due to the language used. One key area for improvement raised was to simplify the wording used in HMRC resources to help provide clarity and a better understanding of what exactly the reform entails. A handful of agencies suggested the use of short videos to explain the upcoming reform.

"You go on the website... it's a complete waste of time in every aspect: IR35, furlough rules, PAYE, NI... it's written as if they write these things to deliberately confuse. I'm not an idiot but it confuses me."

Private sector, fewer than 50 contractors

"It needs to be in layman's terms rather than in jargon."

Private sector, fewer than 50 contractors

Another area of improvement commonly mentioned by agencies was to make it easier to contact HMRC and for HMRC to offer support and guidance through alternative channels. Some alternative

⁶ APSCO is the Association of Professional Staffing Companies.

channels suggested were helplines, a support service via email, online webchats and interactive webinars. One agency noted that HMRC should increase the number of seminars or hosted training sessions about the upcoming legislation. As previously noted, the findings presented in this chapter reflect the support needs of agencies within a specific timeframe (November 2020 to January 2021). During this period, HMRC increased the provision of education and support around the reform to off-payroll working rules. Therefore, the needs for additional support and guidance from HMRC may be different at the time of publication.

"There was one recently where they had a seminar for the construction industry, which sold out in a day so clearly they are in very high demand. That would have been very useful for the last round of the reforms, but also for this one."

Private sector, 100+ contractors

A couple of agencies commented that the CEST tool was a helpful resource for making employment status determinations, and so did not think there was a need for changes to be made. However, some agencies commented that the usefulness of the tool was limited by perceived issues with the scope, clarity, and relevance of questions (as detailed in the previous section). These agencies therefore felt that HMRC should look to make improvements to the tool. Many of these agencies were unclear about the specific aspects of the CEST tool that needed to be improved. However, in a few cases agencies did identify specific areas for improvement. For example, incorporating questions about mutuality of obligation and incorporating guidance about how to interpret questions into the tool itself.

"I think they're good questions, the questions on the [CEST] tool... everything we need is on there."

Private and public sector, 100+ contractors

"The CEST tool needs to be more user friendly. It needs to be completely accurate as well... It doesn't pick up all the different aspects of IR35 accurately."

Private sector, fewer than 50 contractors

A few agencies reported that, due to the delay of the reform from April 2020, it would be beneficial for HMRC to send out reminders about the reform via email that includes a summary of the changes in order to remind them what the changes are and what they will mean for them.

"All the updates I'm getting are like 'remember this? It's back.' We're not getting told it's back and here is a briefing'. It's just 'its' back' and we have to go and find out what it was about again."

Private and public sector, 100+ contractors

Some agencies felt that HMRC should seek to provide more support and guidance tailored to contractors and, to a lesser extent, clients, to ensure that they are aware of the changes and what options are available to them after April 2021. These agencies had spent considerable time and resource educating both their clients and contractors about the upcoming changes – an unwanted burden. Some suggested that HMRC should contact contractors in a similar fashion to how agencies are contacted with regular updates via emails and letters updating them on the reform.

"Offer very clear, non-jargon support. Although these individuals are running their own business and they have an accountant, it's very hard to get real clarity on what it means for them as an individual."

Private sector, fewer than 50 contractors

“I think a lot of contractors have read articles and seen other people’s take on it in articles. Maybe HMRC could have had a slightly more centralised approach in giving out information to them, but it’s difficult to know what the effect would be, everything these days seems to be driven by websites... maybe something of a community approach to them might have helped.”

Private and public sector, 59-99 contractors

7 Views of agencies on the early effects of the 2021 reform

This chapter covers the early effects of the 2021 reform to the off-payroll working rules observed by agencies. It explores the early effects on the number of contractors agencies had on their books; the methods of engagement used by contractors; the rates paid to contractors; and the systems and processes used by agencies. For most agencies, there had been no impact as a direct result of the reform at the time of interview and the early effects reported within this chapter were not mentioned by many agencies.

In this context, the chapter also explores agencies' expectations for the future, although it should be noted that these views were provided three to four months before the reform is due to be introduced and are therefore not rooted in direct experience of the 2021 reform.

Early effects on the total number of contractors engaged through all structures

Some agencies reported early signs of contractor numbers decreasing in the lead up to April 2021 and had seen a similar trend in the run up to the initial date at which the reform should have been implemented (April 2020). This was caused by a reduction in the number of contractors using PSC arrangements.

In their experience, this was because their PSC contractors felt they were required to alter their working arrangements for private sector assignments and because of the perceived effect the reform would have on their net pay. This motivated some contractors to leave the market and no longer work on a contractor basis. These contractors were said to be unwilling to work through alternative structures, such as through the payroll of agencies and umbrella companies, and so would look to find permanent employment.

“When it was supposed to happen in April 2020, we got ready, we sent a letter to everybody and said they had to go on PAYE and loads of them stopped picking up shifts for us straight away. They didn't want to work for us anymore.”

Private sector, 100+ contractors

From a demand perspective, a few agencies mentioned seeing early signs of client demand for PSC contractors reducing ahead of April 2021. In their place, most clients had opted to use contractors that worked through different structures.

“We've got the clients who are bringing the blanket ban [on PSCs] in so we're having to do all new contracts and moving people across to PAYE or umbrellas.”

Private sector, fewer than 50 contractors

A few agencies gave accounts of clients taking an “all-encompassing” or “blanket” approach to contractors ahead of April 2021, regardless of the arrangement they used. In these circumstances, clients had decided to stop using contractors altogether.

“There are [some clients] who have taken an all-encompassing approach to IR35 and have just said they will no longer be taking any contractors.”

Private and Public sector, fewer than 50 contractors

Expectations for the future: number of contractors

When asked about their expectations for the future, most employment agencies expected the total number of contractors on their books, across all engagement structures, to decrease because of the 2021 reform. Agencies that primarily or exclusively worked with private sector clients and those that tended to engage contractors through PSCs typically expected a bigger decrease in contractor numbers.

However, agencies that had prior involvement with the off-payroll working rules in the public sector, and had alternatives to PSCs in place, generally expected the 2021 reform to have less of an effect on contractor numbers. In a few cases, these agencies expected contractor numbers to be unaffected.

Among the few agencies who did not expect a change in contractor numbers, this was often because the skills were specialist and/or in demand. There were also expectations that private sector clients would shift from engaging contractors through PSCs to alternative structures with minimal friction.

“Our expectation is [for the number of contractors to] probably stay the same. We have quite a good relationship with the companies that we work with, and I think that whatever the decision is around whether the contractors are caught or not, we would just work with them to come to the right arrangement.”

Private sector, fewer than 50 contractors

Early effects on methods of engagement: Personal Service Companies (PSCs)

Some agencies had seen the number of contractors using PSCs decline and this had typically been driven by the actions of agencies and their clients. Some agencies and clients had notified contractors about the reform and the way they intend to operate thereafter, motivating some contractors to change their arrangements in preparation. Other agencies and clients had drawn a ‘line in the sand’, i.e. had stopped using PSCs, resulting in the number of contractors using PSCs on their books to drop to zero.

“Primarily because of the reforms [the number of contractors with PSCs] has gone to zero... The company has taken the decision not to do it.”

Private and public sector, 100+ contractors

A couple of agencies emphasised that the decline in the number of contractors using PSCs was not just a consequence of the reform, but also influenced by other factors. For example, agencies said that in the current economic climate contractors have been attracted to working as a contractor on the payroll of agencies because of the enhanced job security and benefits this arrangement offers. Furthermore, one agency explained that the tax benefits of working through a PSC had been diluted by wider changes to tax legislation in recent years.

“I think the other thing to bear in mind that is driving a change in contractors is, whilst the tax regime is beneficial for them, the differential between being taxed in dividends and salary has narrowed over the last three or four years... a contractor would save a lot more in tax five years ago than they would in the same arrangement now.”

Private and public sector, fewer than 50 contractors

Expectations for the future: Personal Service Companies (PSCs)

All agencies expected a decrease in the number of contractors that use PSCs once the reform comes into effect, with many stating an intention to stop engaging with them after April 2021.

"In order to make it as clean as possible... we wouldn't engage them, because it's a more complex payment structure and with it becoming [a] very small [part] to our business we took that decision"

Private and public sector, 50–99 contractors

Some agencies were also of the view that contractors that used PSCs would choose to leave the contractor market altogether (moving towards permanent employment).

Although there was a consensus that the number of contractors using PSCs will decrease, some agencies said that they expected a minority of contractors to continue to operate through PSCs after the introduction of the reform, specifically contractors that work in highly specialised and senior roles. These contractors were expected to retain their PSCs because, for some assignments, they will be deemed to be outside of the off-payroll working rules and so will continue to largely work in the way they did prior to the reform. In instances where they fall inside the rules, it was felt that clients will have no option but to continue to engage some contractors through PSCs because of the need for a specialised skill set that is unavailable or in short supply through alternative methods of engagement.

"If you are a genuine specialist contractor acting like a proper business, then fair enough you should be fine to carry on working that way."

Private and public sector, fewer than 50 contractors

Early effects on methods of engagement: alternatives to PSCs

The agencies that had seen the number of contractors using PSCs decrease in the lead up to April 2021 reported that many of these contractors had closed their PSC and moved over to one of two alternative arrangements: 1) working on the payroll of agencies and 2) working through umbrella companies.

In a couple of cases, agencies did not have alternatives to PSCs available at the time they participated in the interview. These agencies explained, as a result of the reform, they would have to introduce new arrangements, specifically payroll systems and/or links with umbrella companies as part of their preparations for the reform (this is covered further in Chapter 6). This was more common amongst agencies that only worked for private sector clients and had no prior experience of the off-payroll working rules.

Expectations for the future: alternatives to PSCs

The most common expectation was that most contractors will transition from PSCs to agency payroll and umbrella companies (this also reflected the experience many agencies that work with public sector clients reported after the introduction of the 2017 reform).

Focusing on the two primary alternatives to PSCs, the extent to which agencies intended to use contractors on their payroll and contractors that work through umbrella companies varied. Some agencies planned for all contractors to move over to their payroll, some expected all contractors to move over to umbrella companies, and some expected to use a combination of the two.

The expected split between payroll and umbrella company arrangements was heavily influenced by the way agencies operated and the processes they had in place to facilitate these operations. For example, where agencies had an existing payroll offering in place, they often had plans to continue to use this arrangement on a larger scale. Moreover, where agencies had an existing payroll offering and links with umbrella companies, they tended to have plans to continue to use both arrangements on a larger scale. Having these alternative arrangements available was more common amongst agencies that worked for public sector clients.

"Eighteen months ago, we were having people transferring from their limited companies to PAYE. So, we would expect that this time around. Some people with limited companies were glad to get rid of it."

Private and public sector, 100+ contractors

Some agencies anticipated only engaging contractors through umbrella companies after the introduction of the reform, with no intention to introduce an internal payroll system. These tended to be smaller agencies that only worked with clients in the private sector. Some of these agencies had an existing relationship with umbrella companies and planned to continue to use this arrangement.

Although some agencies had plans to use umbrella companies, either in combination with their internal payroll or in isolation, others were opposed to engaging contractors through this arrangement. In a few cases, this was because agencies were sceptical of the practices of umbrella companies and thought their introduction into the labour supply chain could introduce risk.

Early effects on contractor rates

There were very few observed effects on contractor rates at the time of interview as a direct impact of the 2021 reform.

In a few cases, agencies had seen indications that rates were increasing, primarily because contractors were putting pressure on agencies and clients to increase their gross pay. This was done in an attempt to offset the reduction in their net pay from Income Tax and NICs deductions as well as other charges, such as umbrella company admin fees, after transitioning to alternative structures of engagement.

As detailed in Chapter 4, a few agencies reported a similar effect on contractor rates after the introduction of the 2017 reform.

Expectations for the future: contractor rates

Most agencies generally anticipated the rates paid to contractors that previously used PSCs would increase because of the introduction of the 2021 reform.

Rates were generally only expected to increase to partially cover the forecasted reduction in net pay from greater exposure to tax and other charges. Typically, agencies felt that clients and contractors that used PSCs would *'meet in the middle'* with a slight increase in gross pay and a slight decrease in net pay. Only in a couple of instances did agencies suggest that rates would increase to totally offset the reduction in contractor net pay.

"I think there will be a big chunk of clients and contractors who say, 'well let's meet in the middle'. I'll go on umbrella terms and you pay me a bit more, but I don't expect you to make up the whole tax shortfall'. So, for a decent contractor their rates might go up a little bit, but their take home earnings will go down a little bit and the client will be spending a little bit more."

Private and public sector, fewer than 50 contractors

A few anticipated that the rates would decrease. This was because the alternative methods of engagement that most contractors using PSCs were expected to transition to (i.e. agency payroll and umbrella companies) carried additional charges that would need to be deducted from the rates. For example, some agencies mentioned that the cost of health cover, pension contributions, public liability insurance and other administrative fees would need to be factored in.

A couple of agencies expected the rates paid to contractors that previously used PSCs to remain stable after the introduction of the reform. This was because their clients had informed them that they had no intention of changing their payment terms.

"Rates will stay the same because the client pays us the same. Our gross rates will be the same and the gross payment will be the same... But now [contractors] will be on payroll and pay all their tax."

Private sector, 50–99 contractors

Early effects on employment agency processes

As covered in Chapter 6, many agencies had implemented changes to their systems and processes in preparation for the reform. This included introducing and updating payroll systems, establishing arrangements with umbrella companies, and introducing new checks and balances in their day-to-day work.

"We've got our payroll software set up to do the calculations for all IR35. Normally we would just put it through an umbrella company, but we're all set up if need be."

Private and public sector, 50–99 contractors

The nature and the scale of the changes made by agencies varied depending on the way they operated prior to the introduction of the reform and how they intended to operate once the reform comes into effect. For example, those with prior experience of the off-payroll working rules and those with an existing payroll offering or arrangements with umbrella companies were required to make fewer changes to prepare for the reform. These agencies had the processes and systems they required in place already, and so typically just needed to strengthen or expand them. For their counterparts, the changes to their systems and processes were more significant and therefore more time consuming and costly.

"We made that decision only to process and use PAYE basically because it was more efficient and it was less costly, it was a better application of our time. So, we didn't make any changes to tax processing because we fell back on our PAYE processes."

Private and public sector, 50–99 contractors

Expectations for the future: agency processes

In addition to discussing the changes made to their systems and processes in preparation for the introduction of the reform, agencies also reflected on the effect these new systems and processes might have on their day-to-day operations after April 2021. Some agencies, particularly those that had experience of dealing with the off-payroll working rules and those that had alternatives to PSCs available already, held the opinion that their operations would go largely undisrupted.

However, other agencies believed that the administrative work and costs involved in placing contractors in assignments might increase because of these new systems and processes. For instance, agencies mentioned the need to dedicate more internal resource to tasks like managing their internal payroll, checking the arrangements of contractors that continue to use PSCs and auditing the practices of umbrella companies.

“There’s a cost to us in time—mine, my colleagues’, and the admin staff— in administrating it, checking it, and managing it. That is just something we will absorb. We recognise the risk, and we don’t want the liability, so we put the effort in.”

Private and public sector, 100+ contractors

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Whether employer or employee, client or collaborator, we are all humans first and foremost. Recognising this essential humanity is central to how we conduct our business, and how we lead our lives. We respect and accommodate each individual's way of thinking, working and communicating, mindful of the fact that each has their own story and means of telling it.

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