

Understanding IR35

What is IR35?

On 9th March, HMRC issued a bulletin named IR35, detailing how they were going to close the loophole that allowed contractors to avoid paying tax and NICs by using intermediaries, such as personal service companies, composite companies or business partnerships. Essentially, IR35 affects all contractors who do not meet the Inland Revenue's definition of 'self employment'.

IR35 denotes the UK tax legislation designed to tax 'disguised employment' at a rate similar to normal full-time employment. The intention of IR35 (and subsequently IR56) is to ensure that if the relationship between a contractor and their client would have been one of employment, had it not been for the introduction of an intermediary, the contractor pays tax and NICs on the same basis as that of an employee of the client.

Previously, individuals could provide their services to a client company via an intermediary such as a service company enabling the client to make payments to the company without deducting PAYE or NICs. The worker would then receive the money from the intermediary company in the form of dividends instead of a salary, thereby reducing their NICs. HM Revenue & Customs (HMRC) have clearly defined what a personal service company is and have also clarified that other entities employing the services of individuals who work as disguised employees are also caught by IR35.

If you contract your services to one client and are acting as an employee, you cannot avoid IR35 – but you can maximise your earnings.

Are you caught by IR35?

All contractors need to be aware of their IR35 status and their tax obligations (contractors outside IR35 enjoy tax advantages and significantly higher net returns). Your status depends on the terms and conditions of your contract together with your working arrangements. If you have a 'contract of service' you will almost certainly be 'deemed employed (inside IR35), while a 'contract for service' could place you outside IR35 as self employed. However, IR35 is a complex issue and the vast majority of contracts are not exclusively or easily interpreted inside or outside IR35. Many contractors who thought they were not affected by IR35 have been forced to pay back taxes or have been taken to court and lost. Although the actual legislation is to some extent open to interpretation, case law has established a precedent on which a contractor's IR35 status can be assessed.

Key Factors?

If you can answer 'yes' to the following questions you could be deemed inside IR35:

- Does your client have the right to control how you perform your services, what tasks have to be carried out, when and where they must be performed?
- Are you obliged to accept work and is your client obliged to supply work?
- Are you committed to fulfilling your contract personally
- Are you committed to working for just one client?

If you can answer 'yes' to the following questions you could be deemed outside IR35:

- Can you (with written permission from your client) assign someone else to carry out your duties?
- Are you in business on your own account and are you responsible for the success or failure of that business?

While these are important factors, exceptions do occur and your working practice needs to be considered carefully to ensure it reflects your contract. For your own peace of mind you should get your individual circumstances and contract checked by IR35 experts. Even if your current contract is outside IR35, you should have an understanding of the legislation because your next contract may not be.

Dealing with IR35

You cannot avoid IR35 and you cannot choose your own IR35 status (and neither can your end client or agency): it is determined purely by your contract and working conditions. Your contract must reflect the reality of your working conditions and the services you provide as they could be checked by HMRC. Contractors have tried to class themselves outside IR35 by adjusting the wording of their contracts, but this does not protect them from IR35 legislation. You should think very carefully before challenging your IR35 status as this runs the increasing risk of an HMRC investigation and the danger of backdated tax demands, interest payments and/or a fine.

Contractors outside IR35 would, in the past, form their own limited company and pay themselves via the dividend method. If your contract is inside IR35 and therefore subject to deemed employment, you can operate your payments through your clients PAYE even though this is not the most efficient method. Whatever your status, there are alternatives and you may still be able to increase your net income.

Understanding IR35 - Cont.

The introduction of IR35 led to the creation of a service industry dedicated to supporting the lucrative contractor sector and offering (not always legally) a variety of payment solution options.

When looking for a company to manage your payments, you should check:

- They offer a PAYE Umbrella payment solution that is fully HMRC compliant and insured, offering you complete protection against IR35.
- They deal with all your taxation and contract paperwork - so you don't have to.
- They can address all concerns of contractors who do not want the hassle of having additional responsibilities outside of their contract work.

If a company meets these criteria, you can then ask them to provide a personalised illustration for you.

FAQs

I work in an office along side other contractors and employee's and we all undertake the same tasks. We have the same supervisor and take the same directions. Would I be within IR35?

Usually if you are undertaking the same tasks as an employee HMRC would usually state you are a disguised employee and therefore within IR35. Having the same directions from the same supervisor confirms this.

I have to attend the client's site to undertake the work but I can arrive when I like providing I make good progress within the scope of the project and have no direct supervisor. Would I be within IR35?

Attending the clients site itself would not lead to being outside IR35. The fact that you seem to have control over when you undertake the work and the fact you have no supervisor, the methodology of the work belongs to you. On these combined factors your IR35 status would therefore lend itself to being self employed and outside the scope of the legislation.

In calculating whether or not a contractor is within IR35 or not, is there one key factor that determines it?

IR35 is determined by a series of factors and the working practice is key. However, certain clauses within a contract would help lend itself to identifying whether or not it falls within or outside the legislation. However, each and every case must be taken on its own merits and factors.

In choosing a contract what should I look out for in relation to IR35?

For contracts to fall outside IR35 you would be looking for the right of control. You would also expect to put things right in your own time and at your own expense. The safer the contract, generally the more like normal employment the contract becomes.

I am looking for contracts via an agency. Would this alone place me within IR35?

Some agencies specify that the end clients insist on contractors paying PAYE on their income and therefore, word employment contracts in such a way that the contractor would fall within IR35, by agreeing to these terms within the contract you would be changing the working practice. However some agencies are happy for you to personally negotiate terms within the contract and providing the nature of the contract work is that of self-employment then IR35 would not apply. The key is understanding how the contract will be fulfilled, and then word a contract that reflects that when negotiating with your client.

I have been contracting for twenty years. Surely IR35 would not apply as I have not been an employee for that long?

Just because you have been contracting for that long doesn't mean that IR35 does not affect you. Contractors, regardless of how long they have been contracting, can still be within IR35 as each individual contract and set of working practices, can and will, be different.

I run three contracts at once. Am I caught by IR35?

Unfortunately the fact that you have three contracts is not sufficient for you to fall outside IR35. You could find that one, two or all three of the contracts fall within IR35 and therefore you would need to be flexible to the taxation approach undertaken against each one. Each contract needs to be assessed independently to understand how each is affected.

I am considering contracting for the first time. The likelihood is that I would fall within IR35. What options are available to me as I don't wish to run my own limited company?

Various umbrella companies cater for people new to contracting. We would suggest using one of those to help you through your first time as a contractor and definitely when your contract falls within IR35.