

Contractor
.com



A Guide to IR35

Contractor
.com

Content

| | |
|---|---------|
| Understanding IR35 and its implications | Page 3 |
| How HMRC Defines Employed and Self-Employed | Page 5 |
| Top tips | Page 7 |
| IR35 FAQs | Page 10 |

Understanding IR35 and its implications

IR35 is effectively HMRC's way to determine your tax position as a freelancer. For those who genuinely fall outside IR35, it is acceptable to pay yourself through a Limited Company and take dividends. For those who fall inside IR35, HMRC regards you as 'disguised employees' and are only able to receive payment on a PAYE basis.

What Is IR35 Designed To Achieve?

IR35 (also known as Intermediaries Legislation) is set out to define the treatment of individuals' tax affairs through intermediaries. For example, a Personal Service Company (PSC). HMRC state:

"The aim of the legislation is to eliminate the avoidance of tax and National Insurance Contributions (NICs) through the use of intermediaries, such as Personal Service Companies or Partnerships, in circumstances where an individual worker would otherwise:

- *For tax purposes, be regarded as an employee of the client*
- *For NICs purposes, be regarded as employed in employed earner's employment by the client."*

Prior to the introduction of IR35, individuals could avoid:

- Paying taxes as an employee on payments for services
- Paying class 1 NI by providing these services through an intermediary.

Instead of being paid a salary and having PAYE tax and NI deducted, an individual could take the money out of an intermediary (usually a PSC), in the form of dividends, resulting in significant tax savings.

IR35 ensures that if the relationship between the client and the individual could have been on an employee basis were it not for an intermediary, the individual must pay tax and NICs equal to that of an employee of the client.

IR35 does not affect other employment rights, for example, unfair dismissal or redundancy. IR35 only affects an individual's tax status.



HMRC's Definition of Employed and Self-Employed

When it comes to the tax benefits of self-employment, it is key to determine whether an individual works under a contract OF employment (being employed) or, FOR services (being self-employed). How the parties refer to their relationship or consider their relationship is not conclusive. It is the relationship in practice which matters.

To determine the IR35 status of a contract, it is important to apply the factors and tests that the courts have laid down. If the majority of answers to the following questions are 'Yes', it is likely an individual will fall inside IR35 and therefore be considered a 'disguised employee':

- Do you have to do the work yourself?
- Do you have to work a set number of hours?
- Can someone move you from task to task?
- Are you paid by hour, week or month?
- Can you get overtime or bonus pay?
- Can someone at anytime tell you what to do, where to carry out the work or how to do the work?

If the majority of answers to the following questions are 'Yes', the more likely an individual is to fall outside IR35 and be genuinely self-employed:

- Can you hire someone to do the work or engage helpers at their own expense?
- Do you risk your own funds?
- Do you provide the main items of equipment you need to do your job?
- Can you decide what work to do, how and where to do it?
- Do you agree to do a job for a fixed price regardless of how long the job may take?
- Do you regularly work for a number of different people?
- Do you have to correct unsatisfactory work in your own time and at your own expense?

When dealing with IR35 it is better not to be in a position where you have to prove you are not a 'disguised employee' but ensure your workings are in line with the criteria of self-employment.

In conclusion, each specific assignment you undertake will be considered on its own merits based on relevant case law when your IR35 status is to be determined.



Top Tips

The following can be used as a guide to address IR35 implications:

1. Ensure your contracts are accurate and consistent

It makes little sense having a contract that states that you will be subject to the control of the client, or that the client's processes and procedures will apply to you when they don't in practice. In addition, make sure that the upper level contract (the contract between the agency and the client) does not contain anything that contradicts your contract with your agency or the way you intend to work on the assignment.

2. Make sure your client thinks the same way you do

If your client sees you as an extension of its own workforce, the company is more likely to control what you do and treat you as an employee. Make sure they know that you are engaged for a specific reason and that they treat you accordingly throughout your assignment. If the client has more work for you, make sure you put a separate contract in place.

3. Ensure that the client's representative views you as an independent consultant – not just part of the employed workforce

This is particularly important where your client representative is different from the individual who hired your services at the outset of the project. If necessary, provide a copy of your contract to the client representative to avoid any misunderstandings regarding the extent of the services you are providing.

4. Demonstrate that you are treated differently from your client's employees – in terms of the services you provide and how you perform them

Different pay and benefits will not be enough on their own. Flexible working, assignments for other clients, investing in your own training, development and equipment, working on a specific package of work for a fixed fee and/or a fixed period are all good ways of showing that you are truly independent.

5. Working as part of a team does not automatically render you a disguised employee of the client

It is essential however, that you agree the scope of the work you undertake at the outset of the assignment. Being continually allocated further work by the client, particularly without putting in place additional contracts, could show that you are being treated as an employee. If further work comes up, make sure you put a

contract in place before you start working on it. Quote a fixed price or overall fee estimate up front wherever you can.

6. Provide a substitute

Not only does providing a substitute give unequivocal evidence that you are not obliged to offer a personal service, and therefore cannot be a disguised employee, it can also enable you to profit further from the assignment by supplying cheaper labour to perform the services on your behalf. It could also give you the flexibility to work on another contract with a different client, further increasing the income received into your business.

7. Project based assignments are significantly better than period-based ones

Being engaged on a specific project enables you to quote a fixed fee and work flexibly as long as deadlines and project completion dates are met. Being engaged on an ongoing basis may suggest you are only there until the client recruits a permanent employee to do your job. This may indicate that the company is treating you as if you were that individual until someone permanent comes along which can potentially make you a disguised employee.

8. Manage your own assignments

Employees are generally contractually obliged to give up their time for a fixed number of hours each day/week but, as an independent contractor you should determine the hours required to complete the work. It is important that you take control over managing your assignments and don't rely on being allocated work. This should also enable you to quote a fixed fee for the project and/or undertake work for other customers alongside your assignments.

9. Calling yourself a contractor and not receiving holiday or sick pay are not enough on their own to prove that you are not an employee of the client

Your working practices and other terms of the contract must indicate that you are self-employed. This could involve you showing that you have financial risk in terms of bad debts, rectifying work at your own cost and investing in your company, all good 'badges of trade'.

10. Working for multiple clients and investing in your own company is still a good way of demonstrating that you are in business of your own account

The more clients you work for, the easier it is to demonstrate that you are self-employed whereas only having one client as your sole source of income for a lengthy period of time may suggest that you are employed by the end client. To counteract this, pay for your own training, provide as much of your own equipment

as possible and advertise your services on LinkedIn, your website or in magazines like the Yellow Pages.



IR35 FAQs

What is IR35?

IR35 is the industry name for legislation originally contained in Schedule 12 of the Finance Act 2000 also known as “The Intermediaries Legislation”. It states that if you are treated as a disguised employee of the agency or client, your income on that assignment should be taxed as an employed earner (i.e. subject to income tax and national insurance contributions).

Is there a LEGAL DEFINITION of an “employee” or “independent contractor”?

No. There are no statutory definitions of either an “employee” or “independent contractor”. Case law, established by the courts over previous years, is used to determine whether someone is treated as an employee (engaged under a contract of employment) or a self-employed, independent contractor (engaged under a contract for services).

How Can I avoid IR35?

You cannot avoid IR35 if you use an intermediary (such as a PSC). However, there are ways of ensuring compliance with IR35 which is something Contractor.com can assist you with.

How does IR35 affect Umbrella Companies?

It doesn't. Umbrella companies tax all income on a PAYE basis, thus making IR35 redundant.

How is an “assignment” defined?

An assignment is a fixed project or body of work you undertake with a client. Ideally each assignment you undertake should be for a specific body of work or for a fixed period of time as opposed to a rolling contract. This is because “rolling contracts” suggest that you are at the beck and call of the client which means that you are more likely to fall inside IR35.

How long should my notice period be?

Having a short notice period (or no notice period at all) can indicate that your company carries some financial risk in the contract. This is because there is a risk of losing the assignment with little warning. This is the opposite of how an employee would be treated as employees are more likely to have a lengthy notice period to terminate their employment. Therefore, a short notice period will help you to demonstrate that you are not treated as a disguised employee of your client.