

# IR35



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## Introduction

IR35 was introduced on 06 April 2000, in response to a growing trend of people leaving their jobs and registering as self-employed, before being hired by the same company they just left on a long-term basis – often doing the exact same job they did prior to registering themselves as self-employed. By registering as a Limited Company, they were able to reduce their Income Tax and National Insurance bills.

However, because these individuals were in effect being directly employed by the companies they were working for, the government's view was that they were not entitled to the tax advantages that they were receiving, and the IR35 regulations were introduced.

If the Inland Revenue decides they will calculate what is known as a 'deemed payment', treating all income as salary and asking for Income Tax and National Insurance contributions on income originally paid out as dividends. IR35 works by taxing the profits of the Limited Company as income, and by requiring the company to pay National Insurance contributions.

## Major points to consider for IR35

### Practical working arrangements matter

IR35 regulations cover not only the written contract relating to your assignment but to the day-to-day working arrangements that you adopt as well. Therefore it is vital that you thoroughly review your written contract and ensure that actual working practices are in accordance with the written contract.

If HMRC wishes to determine whether you are within or outside IR35 regulations, a Status Inspector will usually seek information from you and your client about the way you are providing your services. This information is known as the „hypothetical contract. This means that both you and your client must be clear about the way that your contract is being conducted.

You should also ensure that your agency, if you are using one, is using the same contract with your client as it is with you because a recent High Court decision means that the contract between the agency and the end client may be used to determine whether the contractor is within or outside the IR35 regulations. If you are a contractor or freelancer, Skytax Accounting Ltd can help you determine whether a given contract is caught by IR35, and can also provide you with a contract which is not caught by IR35.

## Personal service and the right of substitution

When the HMRC investigates a contract, the focus is often to determine whether or not a worker is providing „personal service. A personal service in this case means that the client has been promised the services of a specific person to deliver a particular contract. A key test here is whether there is a right of substitution – that is, could the contracting company substitute the services of one individual within the company for the services of another individual within the company.

If the contracting company could substitute the specific person providing the services in this way, then the company would not be providing personal service and the contract would not be caught by IR35. Of course, even if you are self-employed, you may be required to provide some level of personal service, because it might be that without your skills the company would not be able to deliver the contract.

To avoid being caught by IR35, contracting companies should ensure that the contract they strike with their client does not require them to provide the services by any one specific employee of the company. This is known as the Right of Substitution.

The first step in demonstrating the Right of Substitution is to ensure that the written client agreement is clear that the contracting company, rather than any particular employee, is to undertake the work. The Right of Substitution must be agreed by both parties and it must be possible to use the Right. HMRC tend to regard the Right of Substitution as being almost irrelevant to the question of employment status unless it is actually put into use – this means that it can be beneficial to use this Right.

## Employees do not tend to provide their own equipment

While employees of businesses tend to use the equipment provided by their employers, people who are self-employed tend to own and use their own equipment. Having your own equipment, and using it to undertake the work you have agreed with the contracting company, is therefore a good sign that you are genuinely self-employed. It can also help to demonstrate that you have invested in your company and that you are taking a risk with it, which both helps to show that you are genuinely operating your own business.

## Financial risk

Whereas employees of a business are usually insulated from financial risk, the concept is familiar to many contractors. Essentially financial risk means that you are taking on responsibility for delivering your service to your client at no financial risk to them. The flip side of this risk is that you also have the opportunity to profit from your contract by delivering it more cheaply, or more quickly than was originally expected. A fixed-price contract is an example of a contract which introduces a degree of financial risk, in that if the work took longer than expected, or involved greater cost on the part of the contracting company, then the contracting company

would lose out. On the other hand, if the contracting company delivered the work more quickly than expected, or more cheaply, it would gain.

### **HMRC would consider the following evidence that you are taking on financial risk:**

Providing your own equipment, taking out insurance to cover yourself and your client against negligence or mistakes in your work, having responsibility to correct any errors in your work at your own expense.

### **Basis of payment**

The way that you are paid by your client company can be used as evidence for whether you are employed by them or self-employed. Hourly timesheet recording, references to standard and „overtime pay rates, and usage of the same expense-claiming processes as your client’s employees would both be considered indications that you are employed by your client. In addition, you should always ensure that you submit invoices to your client if you wish to be considered self-employed.

### **Exclusive services**

Being able to take on work for more than one client at the same time is a hallmark of being self-employed rather than directly employed. If your client asks you to undertake not to work for any other clients at the same time as you are working for them, you should refuse as this would be considered evidence that you are in fact directly employed.

### **Becoming a part of the client organization**

If you work on site at a client organization, there is a risk that you may unintentionally come to be regarded as being a part of that organization. This is more of an issue for longer term contracts. You need to ensure that you are not fully integrated into the client’s organizational processes. In the main, the risk comes from any activity or behaviour that makes it harder to tell whether you are a contractor or an employee of the business. Things to look out for include: Any management relationships with the client’s staff – including managing or being managed by them Submitting formal sick leave notifications Requesting annual leave through company processes Wearing uniforms or other corporate dress Using stationery or business cards belonging to the client organization Having a job description or job title Having appraisals, or performance related pay.

### **Right of dismissal**

If the client company has a right to dismiss you from the job, it can be considered as indicative of an employee-type relationship. If the contract must have a clause related to dismissal, you should ensure that you also retain a right to end the relationship so that the balance of control is at least equal.

## Mutuality of obligation

All contracts involve a degree of mutual obligation. The client is obliged to pay for the work requested, and the contractor is obliged to complete it for the price agreed. However, if the contract is loosely worded, or goes on for a long time without there being a specific account of exactly what services the contractor is supplying, there is a risk that a Mutuality of Obligation may be deemed to have begun. A common scenario is when a contractor is taken on and simply completes task after task for the client company, without these new tasks being written into the contract. The situation could reach the point where the contracting company expected the client to continue providing work for the contractor to carry out, while the client assumes that the contractor will take on any work he is given. In this case, it is likely that HMRC would consider that there was a Mutuality of Obligation between the two parties which resembled direct employment rather than a self-employed relationship. To avoid the impression that a Mutuality of Obligation has arisen between you and your client, you should ensure that the precise content of the work you are undertaking for the client is documented, including expected timescales, and that any changes to the work you are undertaking are also documented so that it does not appear that you are simply taking on all work the client puts your way.

## Are you in business “on your own account”?

The question of whether or not you are in business on your own account gets to the heart of what the IR35 regulations are about. It is the difference between a contracting company and a „disguised employee? Who is simply describing himself as a Limited Company in order to reduce his tax liabilities. Factors that would contribute to the impression that you are genuinely in business on your own account would include: working for several clients, and especially for several clients at the same time, working from your own premises and using your own equipment, having your own stationery or business cards, seeking out further contracts, advertising for new business and having employees or subcontractors. Contrastingly, factors which would suggest you are in fact a disguised employee would include: working for a long time for one client, and making no obvious effort to find other contracts.

# Tax Implications of IR35

## What if my contract falls within IR35

Accounts Direct can work out your tax liabilities for you, regardless of whether the contract you have taken on is within or outside the scope of the IR35 regulations. Clearly, for tax purposes, it is preferable to be outside the IR35 regulations and Skytax Accounting Ltd can assist you in drawing up contracts which make it much less likely that HMRC will consider you to be directly employed by the client company. What if my contract falls within IR35 If a contract you are working on is caught by IR35, there are specific rules set out by HMRC that tell you how to determine how much tax you need to pay. HMRC also specifies that you must pay the majority of your income as salary, although there are some expenses you may deduct from this total.