

Guide to understanding IR35



Whether you are starting out in a contract or freelance career, or have been working that way for a while, it is **essential** to be familiar with the basics of **IR35**.



boox

people • advice • technology

Contents

What is IR35 and who does it apply to?

3

Determining IR35 Status

4

- › Caught or not caught?
- › HMRC CEST Tool
- › Who determines an IR35 status?
 - › Public Sector contracts
 - › Private Sector contracts

4
4
4
5
5

Impact of IR35 and different ways of working

7

- › Limited Company (PSC)
 - › Advantages
 - › Disadvantages
- › Umbrella Company
 - › Advantages
 - › Disadvantages

8
8
8
9
9
9

Dealing with an IR35 enquiry

11

IR35 Guide 2018

Whether you are starting out in a contract or freelance career, or have been working that way for a while, it is **essential** to be familiar with the basics of **IR35**.

What is IR35 and who does it apply to?

IR35, or Intermediaries Legislation, is a piece of tax legislation that first came about back in 2000 designed to combat tax avoidance from what HMRC saw as “disguised employment” by individuals supplying services through limited companies.

In the Revenue's eyes if someone is doing the same work, in the same place, in the same way as an employee, they should be taxed as an employee.

IR35 only applies to workers operating through limited companies, also called Personal Service Companies or PSCs, or Limited Liability Partnerships (LLPs). It does not apply to umbrella company workers, direct employees on PAYE payrolls, or self-employed sole traders.

IR35 status

Each contract has to be assessed for its IR35 status. The IR35 status of a particular contract hinges on whether you would be classed as an employee if you were not working through a limited company.

If, on that contract, you are determined as “caught by” or “inside” IR35, you are deemed as a “disguised employee”.

If, on that contract, you are determined as “not caught by” or “outside” IR35, you are deemed to be genuinely in business in your own right, supplying your services in a business to business transaction.

The IR35 status of an assignment dictates what type of tax and how much tax you pay on that contract's sales. If an assignment is classed as caught by IR35, most of the income paid to the limited company will be subject to PAYE tax and National Insurance deductions.

It is important to stress that IR35 status applies to the contract, not the individual. This means that in the course of your contracting career you may be offered both IR35 caught and not caught contracts, with different tax treatment for each. Indeed you could be operating both at the same time, for example if you work for one client during the week and another at weekends.

To quote HMRC:

“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 an employee of the client”.

Determining IR35 Status

Caught or not caught?

There are two main factors which drive IR35 status - the written contract between your limited company and your agency or end client and how it reflects your actual working practices.

In the case of an IR35 investigation, HMRC will consider both elements to decide whether the relationship is one of employment or one of business to business services. They will also look at the contract between the agency and end client. They may also speak to representatives of the end client and agency as well as to you, in order to determine how the contract is being operated.

The tests which determine IR35 status are complex and have evolved out of decades of case law. Among other factors, the following “tests of employment” should be considered:

Mutuality of obligation - Is the agency or client obliged to offer work and is the worker obliged to take it, both during the contract and between assignments.

Substitution - Is the personal service of the worker required, or can they send a substitute to do the work?

Control - What degree of control does the client have over what, how, when and where the worker completes the work?

For a contract to be classified as caught by IR35, the tests must indicate an employment relationship in all 3 of the above areas.

In short, HMRC are seeking to establish whether the relationship is one of employment, or one of business to business services.

HMRC CEST Tool

HMRC have developed an online tool known as CEST - Check Employment Status for Tax. This tool is designed to assist workers, clients and other relevant parties to ensure that a contract's IR35 status is correctly determined.

CEST uses a series of questions to determine whether the worker is employed or self-employed for tax purposes.

HMRC have said that CEST is the only IR35 decision-making tool they will stand by. However, it is worth noting that they also state that use of CEST is not compulsory, nor do they have a formal appeal process if you think an outcome has been determined incorrectly. ➡

Determining IR35 Status continued...

Who determines an IR35 status?

Historically, the individual director of the limited company carried the responsibility for determining the IR35 status of their contracts. By signing-off annual company accounts and corporation tax returns, the individual gave a declaration that they had operated IR35 correctly. Likewise the Personal Service Company was liable for underpaid tax, NIC and penalties in the event of an IR35 investigation by HMRC.

However, in the Budget of 2016, the government set the wheels in motion for things to change. HMRC took the view that only a small number of limited company contractors were correctly classifying themselves as operating outside of IR35, and as a result, the treasury was missing out on a considerable amount of tax revenue.

Public Sector contracts

From April 2017, for work in the public sector only, responsibility for determining an IR35 status switched from the individual to the Public Sector Body engaging them. If the Public Sector Body decides that the contract is within IR35, then the party paying the personal service company – the “fee-payer” – must tax the contractor at source, exactly as they would an employee on their payroll.

Private Sector contracts

In the private sector, it remains the responsibility of the Personal Service Company director to determine their IR35 status and apply deemed payments on their income if the contract is caught by IR35.

However, in the Autumn 2017 Budget, the government announced a consultation on extending the public sector IR35 determination rules to the private sector. It looks increasingly probable that the way IR35 is applied will be the same across the board. This means that it is likely that every assignment or contract taken by a PSC will have an IR35 status determined at source which will control which taxes are applied.

A further announcement by the government is expected during 2018, but they have not specified when.

»» Need anymore help
with your accounts?

Visit our Help & Advice section at
www.boox.co.uk/help-and-advice



people • advice • technology

boox.co.uk 5

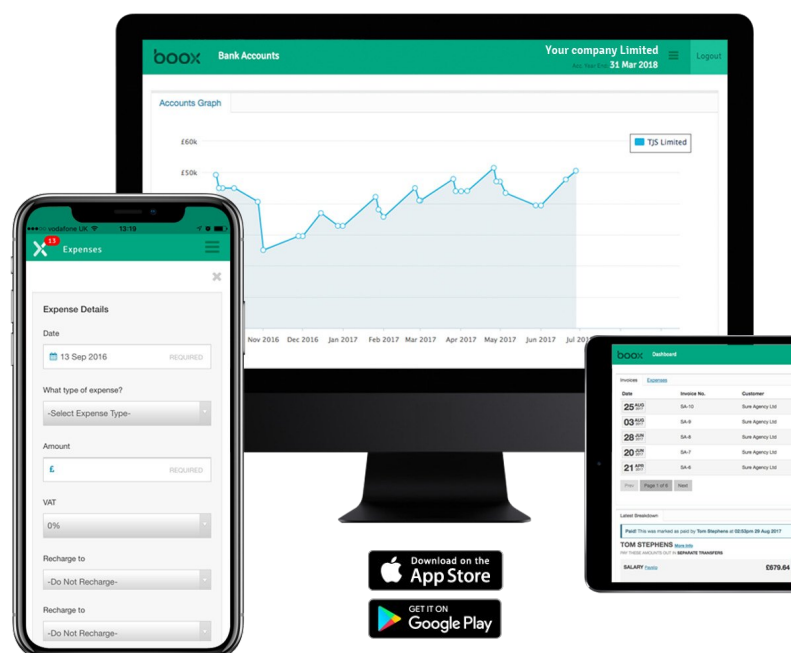
Get it today

FREE app trial

Our online accounting app helps put **you in control** of your **business finances**.

- ✓ Smart financial health checks
- ✓ Real-time pay breakdowns
- ✓ Connect your bank account

Go to www.boox.co.uk/app-tour/



Download on the
App Store

GET IT ON
Google Play

Impact of **IR35** and different ways of working

If your contract is deemed as caught by **IR35** (regardless of who makes that determination), your gross earnings will be subject to “deemed payments”, in other words you will pay the same amount of **tax** and **NIC** as any other employee.

This means that the take home pay between PSC and Umbrella contracting will be very similar, (assuming both are paid at the same rate).

Generally, rates are higher when you are paid either through a limited company or Umbrella company than being employed directly, although direct employment may offer more security if such positions are available.

Whilst tax should never be the main determining factor in deciding how you work, we understand that it is one of your considerations.

When it comes to contracting, freelancing or working as a locum, there are two common ways to operate and ultimately get paid. There are advantages and disadvantages of each so in this section of the guide, we will explain these.

»» **Need anymore help
with your accounts?**

Visit our **Help & Advice** section at
www.boox.co.uk/help-and-advice

Limited company (PSC)

Operating as a **limited company** or **PSC**, gives you total control of your business activities and traditionally provides a higher take-home pay. However, owning a business comes with certain legal obligations and if your contract is caught by **IR35** you will still need to manage all of the administration, even if deemed payments are being operated by your agency.

Advantages

Control - With a limited company you have complete control over your business activities.

Take-home pay - A limited company may provide you with a higher take-home pay as you can decide on the most tax efficient way of taking money from your company. (This may not be the case if all of your contracts are caught by IR35).

Engage in multiple activities - Since you are running your own business, you can undertake business activities outside of your main contract and if these are not caught by IR35, income from them will not be subject to deemed payments.

Protection of personal assets - Your company is a separate legal entity to you, therefore your personal finances and assets should be protected in the event of a claim against your company.

Reclaim expenses - You can get tax relief on business expenses through your company and take advantage of tax relief on lifestyle benefits such as pensions and life insurance.

Avoid the hassle of switching - If you have been operating as a PSC, then switching to an Umbrella company means changing over to a new system and learning new processes. Also, if you move between agencies, it is likely that you will have to change Umbrella providers.

Disadvantages

Setting up - Setting up a company requires you to register a company name, address, directors and create an Articles of Association document. You will also need to set up a business bank account.

Legal obligations - As the Director of a limited company you will be responsible for managing your company accounts and ensuring you are working in a compliant manner, including correctly applying the IR35 rules.

Meeting deadlines - There are a number of official deadlines you need to meet including filing your accounts and Company Tax Return, paying Corporation Tax and submitting a personal tax return every year.

Retaining financial records - It is a legal requirement to retain financial records for at least 6 years from the end of the last company financial year they relate to.

Cost of closing the company - When you decide to cease trading you are responsible for the cost of closing the business and following the correct legal process for doing so.

Umbrella company

Umbrella companies engage flexible workers under an employment relationship. The Umbrella company takes care of all the **tax** and **NIC** and all administration, so it is typically a very simple way to work.

Advantages

Quick and easy to set up - Registering with an Umbrella company is usually simple and can be done quickly online or over the phone. You will just need to sign a contract and submit a few documents to prove your identity.

Minimal paperwork - To get paid you just need to submit your timesheet and expenses. Some Umbrella companies also offer SMS pay alerts to make your admin even easier and to give you peace of mind.

Taxed at source - You don't need to worry about calculating income tax and NIC, all of this is done for you by the Umbrella company.

Statutory benefits - As your employer, the Umbrella company will offer statutory employment benefits, including at least 28 days holiday, SSP, maternity and paternity pay.

Additional cover and perks - Since many Umbrella companies look after a large number of employees, you can benefit from comprehensive insurance cover and other perks and discounts.

Disadvantages

Lack of control - You do not have as much control over your business activities as you do with a limited company. You are also reliant on the Umbrella company processing your invoices and promptly collecting your money.

Not geared for growth - An Umbrella company will not support your business plans should you want to develop beyond working as a contractor. You are an employee of the Umbrella company.

Other income - If you earn income outside of your contract, you will need to find a way to get paid - be it a new Umbrella, limited company or as self-employed.

Expenses - Dependent on your Umbrella arrangements you may need to claim tax relief on your expenses through a self-assessment tax return or a P87.

Unscrupulous providers - Certain providers are operating tax avoidance schemes under the guise of Umbrella companies. If it looks too good to be true, it probably is. HMRC are actively looking at contractor loan schemes and offshore providers, with people who have used such schemes getting nasty tax bills, sometimes many years later.

If you choose to use an Umbrella company, always use an FCSA-accredited Umbrella company to ensure you are not left with an unexpected tax demand.



»» Need anymore help
with **your accounts?**

Visit our Help & Advice section at
www.boox.co.uk/help-and-advice

Dealing with an **IR35** enquiry

Any contractor operating outside of **IR35** and taking dividends from their company runs the risk of a status enquiry where **HMRC** reviews your **IR35** treatment. If **HMRC** believe your situation warrants an investigation, you will receive an initial review letter which could request the following information:

- › A complete breakdown of your limited company's income for a specific accounting period(s).
- › Copies of all contracts which are associated with your income.
- › Any evidence and information to support your opinion that your contract(s) is outside of IR35.

Be aware that HMRC have powers to obtain any information they need as part of the investigation. This may include approaching your end client directly to ascertain how they view and treat you as a supplier.

In the event of an **IR35** enquiry, you have approximately one month to supply **HMRC** with all the information they request, but it is important to take the following steps:

- › Contact your accountant (if you have one) to start the process of pulling together all your financial information.
- › Remember though that it is likely they will charge you for time taken to assist you.
- › If you already have IR35 insurance, contact your provider.

»» We're here to help

Call our friendly team on:

0808 168 0422

(Open 8.30am to 5.30pm Monday to Friday)

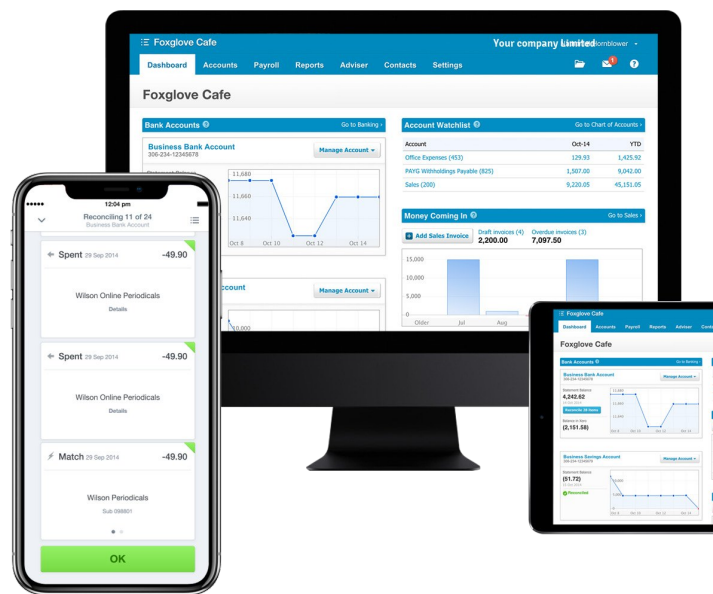


people • advice • technology

boox.co.uk 11

What works for you?

As well as our own agile accounting app, we support other market leaders in accounting software, to fit in with what works best for you.



»» Ask about our flexible accounting packages for sole traders and small businesses - call:

0808 168 0422



people • advice • technology

boox.co.uk 12

Help and support from Boox

If you are a **Boox** client and have made the decision to close your company, we will work with you to ensure the closure is handled fully and correctly so that you are not exposed to the consequences of getting it wrong.

Download our full range of guides



people • advice • technology

boox.co.uk 13

The Boox Team are here to help

 0808 168 0422

 sales@boox.co.uk

 boox.co.uk

boox

people • advice • technology

boox.co.uk

Disclaimer: Although we attempt to ensure that the Information contained in this publication is accurate and up-to-date at the date of publication it may not be comprehensive, we accept no liability for the results of any action taken on the basis of the information they contain and any implied warranties, including but not limited to the implied warranties of satisfactory quality, fitness for a particular purpose, non-infringement and accuracy are excluded to the extent that they may be excluded as a matter of law.