



A Guide to IR35

What is IR35?

IR35 is a piece of tax legislation that was brought in with the Finance Act in 2000 by the government. It is designed to prevent tax avoidance by personal service companies, and aims to tax 'disguised employees' at a similar rate to those in full-time employment.

IR35 aims to catch out workers who are avoiding paying tax and National Insurance Contributions (NICs) by operating as limited companies, when they should be full-time employees.

For example, if you previously worked as an employee for a company, and show up the next week as a limited company working through an agency, you won't pay the same in tax and National Insurance.

If you provide the same service to the same client on more or less the same contractual basis, the chances are you're trading within IR35.

HMRC will use the 'hypothetical contract' between yourself and your client to determine your employment status.



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If HMRC decides your contract puts you within IR35, you'll have to pay tax and NICs, rather than taking your director's salary and dividends (which is much more tax efficient).

For those within IR35, who are viewed as trading as a personal service company solely for tax avoidance reasons, they are described as a 'disguised employee'.

If you're a disguised employee you may also be referred to as being 'inside' IR35. If you're not a disguised employee you are 'outside' IR35.



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Are you a contractor or disguised employee?

Unfortunately there is no definitive rule to say whether someone is inside or outside IR35, instead the situation as a whole should be considered.

Contractors should regularly look at their risk to the legislation and assess whether or not they are likely to be caught by IR35.

Although fairly unlikely, HMRC can randomly investigate your business to assess your IR35 status, so it's important that you can demonstrate that you have assessed your risk regularly and can demonstrate that it's unlikely you're inside IR35.



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Determining your status

Determining your status is based on the 'hypothetical contract' between you and the client. The circumstances under which you work are outlined in the hypothetical contract. HMRC makes a decision based on these circumstances as to whether the individual is a genuine contractor or a disguised employee.

There are a number of case law judgements that HMRC use to determine whether an individual falls within IR35.

However, there are three key case laws used which are widely recognised to be the defining factors of determining if a contractor is inside or outside IR35.

- ✓ control
- ✓ mutuality of obligation
- ✓ personal service (and substitution)

These are believed to be some of the most important factors to consider.



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Control

Control focuses on how the work is undertaken and who has control of it. The main points HMRC will consider are the working hours and the location where work is carried out. If you're a contractor who's allowed to complete the work at any time and in any location, it looks like you're acting as a genuine contractor.

However, if you're given a specific time frame to complete work in (such as 9-5, Monday to Friday) and you must travel to and from the same location every day to complete it on the client's premises, then it's likely you'll fall under the definition of a disguised employee. This can get complicated when work must be carried out on a certain premises, such as with those contractors working on building sites, so it's worth speaking with a professional if you're unsure.



Mutuality of obligation

Mutuality of obligation is concerned with the duties the client and contractor are obliged to fulfill. For example, an employed person is expected to give notice before they leave a job, and work for that amount of time before leaving. However, a contractor has the right to walk away from work with a short notice of leaving. There may not even be a required notice period for some contractors.

A contractor is also likely to complete a contract and not expect any further work to be given to them, as the client is not obliged to do so. On the other hand, a full-time employee would expect to be given more work by their employer after they've completed a project.



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Personal service (and substitution)

The personal service clause is concerned with the roles of client and contractor in terms of who is able to delegate work to others.

As a contractor, if you're unable to complete the work you will be able to delegate it to whoever you deem fit. However, full-time employees are not expected to delegate work, as it is the employer who is expected to delegate work.

If your client allows you unlimited delegation, the chances are you don't fall within IR35. Likewise, if your client allows you complete control over choosing your own substitute should you be unable to complete a project, you are unlikely to be trading as a disguised employee.

Aside from these three, here are some of the other case laws that are used by HMRC to determine an individual's status:

- ✓ provision of equipment
- ✓ financial risk
- ✓ basis of payment
- ✓ part and parcel
- ✓ exclusive services and length of engagement
- ✓ right of dismissal
- ✓ intention of the two parties
- ✓ business-like trading



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Working inside IR35

If you are deemed to be inside IR35 then there are a number of options available to you to engage with your client:

You can use an umbrella company. Umbrella companies can be useful if you envisage having a very short contract, as there will be less hassle. Umbrella companies will manage your invoicing to the client and pay you through PAYE. However umbrella companies can be less tax efficient.

Alternatively, you can trade as a limited company but take the profits of the contract as a salary. This is more tax efficient than an umbrella company because you can still benefit from the VAT flat rate scheme and a flat 5% expense rate along with other expenses.

Our advisors are able to give you the best advice about what to do next, and can help you find the most tax-efficient way of trading within IR35.

If you're unsure about whether you're inside IR35, or if you are inside IR35 and want to know more about your options, just give us a call.



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Frequently asked questions



How can I avoid IR35?

If you're worried about falling within IR35, there are a few ways you can help yourself steer clear. First and foremost, behave like a business. Create a contract for each project and include on it terms of Control, Mutuality of Obligation and Personal Service. This will be affected by how you act as a contractor on a day-to-day basis.

Make sure your project has an end date, and that the contract is valid for the length of time you will be working for the client. Including a short-term notice period will also work in your favour if you are ever investigated by HMRC.

Failing to market your business may work against you if you become the subject of an IR35 investigation. Keep the eyes off you by creating a business logo, a name (not your own) and a website that markets your services.



Does it matter how long I have been working with a client?

The length of a contract with a client alone won't mean you automatically fall under IR35. However, the longer you do work with a client for, the easier it will be for HMRC to assume you are working as a disguised employee. It will also become harder to demonstrate your independence from the business in the event of an investigation.



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Should I avoid working with a client if I have worked with them before?

If you were previously employed by a client, and are now working for them as a contractor, you are at high risk of being caught by IR35. If you previously worked with the client when you were a contractor, there's a lower risk of being caught inside IR35. However, you should take steps to make it clear that you are treated as a contractor rather than an employee.



What is a personal service company?

Typically, a personal service company is a limited company that has a sole director/shareholder. A personal service company provides professional services to a client which require the skill or experience of a contractor.



If my contract falls under IR35, will it affect the rest of my career as a limited company?

Each contract is treated individually. That means, if you have a number of contracts with different clients, they will have to be reviewed separately to decide if each one falls under IR35. Going forward it won't affect your career as a limited company you will just have to pay tax and NICs as a full-time employee would.



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Looking for more help on IR35?

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