

## IR35 Legislation Summary

### What is the background?

Commonly referred to as IR35, Intermediaries legislation was introduced on 06 April 2000. It was first proposed by the Chancellor in the 1999 Budget and details were given in a Budget press release numbered IR35.

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; and
- ▲ For NICs purposes, be regarded as employed in employed earner's employment by the client.

Prior to the introduction of the legislation, an individual could avoid being taxed as an employee on payments for services and paying Class 1 NIC by providing those services through an intermediary.

The worker could take the money out of the intermediary, normally a personal service company, in the form of dividends instead of salary. As dividends are not liable to NICs, the use of a dividend remuneration strategy results in the worker paying less in NICs than either a conventional employee or a self-employed person. And PAYE would not apply to the dividends.

The legislation ensures that, if the relationship between the worker and the client would have been one of employment had it not been for an intermediary the worker pays tax and NICs on a basis which is fair in relation to what an employee of the client would pay.

### Who is affected?

All freelance contractors owning and operating a Limited Company. Initially the legislation was targeted at the IT sector however this was quickly extended to encapsulate all contract industries. All contractors have a responsibility to determine their own tax status and must consider whether their contract terms & conditions and their working practices fall inside or outside of the legislation on each assignment they agree to undertake.

Contractors who are genuinely self-employed (Sole Traders), or operate properly through a limited company will be outside of IR35.

### Are you genuinely self employed?

If contractors cannot prove they are genuinely self employed they will be deemed to be inside of IR35 and will be required to pay income tax and national insurance like conventional PAYE employees.

HMRC have produced guidelines to help contractors determine their self employment status in the form of a publication named IR56.

### How can contractors demonstrate compliance?

The main elements of IR35 compliance relate to the terms and conditions of the Contract for Services and the actual working practices of the assignment undertaken. Taking each of these in turn, the:

#### Contract for Services

- ▲ Must accurately reflect the terms and conditions of the engagement
- ▲ Must confirm an unfettered right of substitution and the ability to delegate work to others
- ▲ Must confirm that there is both financial risk and the opportunity to profit from sound management
- ▲ Must confirm that no mutuality of obligation or exclusivity exists between the contractor and client
- ▲ Must confirm that the client does not control/direct/supervise the work carried out by the contractor

#### Working Practices

Must be able to demonstrate and prove that the contractor is treated significantly different to and performs differently to the clients own staff. Positive indicators of this are:

- ▲ The contractor is not subject to the clients staff appraisal and review processes
- ▲ The contractor is not subject to the clients grievance and disciplinary procedures
- ▲ The contractor is identifiably different (e.g. ID passes) to conventional staff
- ▲ The contractor supplies all of his/her own equipment and materials
- ▲ The contractor provides directly for all of his/her own training requirements
- ▲ The contractor does not take advantage of facilities provided by the client to conventional staff (e.g. subsidised canteen, social events)
- ▲ The contractor does not receive statutory entitlements from end clients (e.g. holiday pay, sick pay, maternity/paternity pay)
- ▲ The contractor does not receive benefits typically awarded by the client to conventional staff (e.g. bonus payments, share options, pension)

The above lists are not exhaustive and are only provided for guidance. All contract terms & conditions and working practices will be uniquely different and must be reviewed on a case by case basis.

### **What if a contractor is deemed to be inside the legislation?**

If a contractor is considered to be inside IR35 legislation, they will receive most of their income in the form of a 'deemed payment' where income tax and national insurance will be deducted as it would for a conventional PAYE employee.

There is however an ability to offset some particular expenses and obtain certain other benefits. These include:

- ▲ Flat 5% reduction to the deemed income to cover administration costs
- ▲ Employers NI contributions
- ▲ Contributions to company pension schemes
- ▲ Allowable employee expenses that are "wholly, exclusively and necessarily incurred in the performance of the duties of the employment"
- ▲ Subscriptions to HMRC recognised trade bodies / professional institutes
- ▲ Flat Rate VAT entitlements
- ▲ Professional Indemnity insurance costs

### **What if a contractor is deemed to be outside the legislation?**

If a contractor is considered to be outside of IR35 legislation they can benefit from a range of entitlements. These include:

- ▲ The ability to set bespoke salary levels
- ▲ The ability to declare interim dividends
- ▲ Tax relief on capital / revenue business expenditure
- ▲ Contributions to company pension schemes
- ▲ Flat Rate VAT entitlements

### **What is the financial difference between being inside and outside of the legislation?**

A contractor deemed to be inside IR35 will take home approximately 20% less than someone who is providing services outside of the legislation.

As a rule of thumb, contractors earning £30.00 per hour will be £640 per month better off if they are deemed to be outside of IR35 legislation and able to take advantage of all appropriate tax planning opportunities.

## What are the penalties of getting it wrong?

From April 2009, new rules mean that contractors will have to prove they have taken "reasonable care" to demonstrate that their contracts and working practices are not caught by IR35 legislation.

If HMRC do establish an IR35 fail, the contractor will be liable for backdated payments of Income Tax, Employers & Employees National Insurance to the start of their contract assignment. The contractor will also face a charge for loss of bank interest over the period and may receive a fine for not applying the correct rules.

In addition to the above costs, the contractor will also be forced to spend a considerable amount of money on professional fees to fight and defend the challenge.

It has never been more important for contractors to solicit the very best IR35 advice and support they can find.

## How can I be sure of my status?

Contractors must take independent advice from employment law experts. This advice should be pro-actively sought at the start of every contract assignment and, if they are long running engagements, at regular subsequent intervals.

All Champion clients benefit from free guidance and expert IR35 advice.

In conjunction with our employment law partners Weightmans LLP, we invite all new and existing clients to partake in full reviews of their Contracts for Services and working practices.

For clients selecting our Standard Plus service, Weightmans LLP will provide, at no extra cost, an IR35 status assessment and the necessary professional guidance to deliver true added value and peace of mind.

## Summary

IR35 legislation is complicated and must be thoroughly considered before any important decisions are made. These notes are designed to provide summary information only and further advice can be sought by speaking to a qualified Champion advisor.

**Call 0845 313 2760 or 0161 703 2549 today to discuss your needs.**

