

## **IR35 - WHAT YOU NEED TO KNOW**

IR35 has a reputation for being confusing; this is mainly because being caught by IR35 or not greatly depends on your individual situation, your working practices and the particular contract that you are carrying out. As a contractor, it is essential you are aware and educated on how your circumstances impact your IR35 status. So to bring some clarity to what can seem a bewildering topic, we have created this guide which tells you all you need to know regarding IR35.

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## WHAT IS IR35?

IR35 is a piece of government legislation that was put in place to combat disguised employment. Contractors who do not meet the definition of self-employment set out by HM Revenue and Customs (HMRC) and are seen as disguised employees, may find that they are caught by IR35, which will increase their tax and national insurance obligations.

The legislation was first put in place in April 2000 with the purpose of preventing contractors from receiving the benefits of permanent employment, such as job security, as well as the tax benefits that are available to limited company contractors

## WHAT IS CLASSED AS DISGUISED EMPLOYMENT?

A simple example of disguised employment would be if a person was to leave their permanent position one week, only to return to the same position with the same responsibilities the following week, however this time on a contract basis working for their own limited company. In such a case, the individual in question would be classed as inside or caught by IR35.

When using the above arrangement the original employer would avoid paying Class 1 National Insurance Contributions (NIC) at 13.8% and the 'former employee' can arrange their payments between salary and dividends which would minimise their tax and NI liabilities.

The government introduced the anti-avoidance legislation known as IR35 in April 2000 with the intention of eliminating this problem.

## WHAT IS INSIDE AND OUTSIDE IR35?

If your contracting position is giving you the same benefits as your client's full-time employees, then you may be inside IR35, or caught by IR35. Some examples of employee benefits are:

- Job security
- Sick pay
- Holiday entitlement
- Pension contributions

A contractor who is outside of IR35 would be working as a separate entity and would not be receiving the benefits that permanent employees receive. As a limited company contractor who is working outside of IR35, you are entitled to increased tax planning opportunities, which compensate for the lack of job security and other benefits.

## WHAT FACTORS CONSTITUTE BEING INSIDE OR OUTSIDE IR35?

The regulations that surround what constitutes being inside or outside IR35 are extremely complex, and as mentioned above, will depend on the contract in question and your working practices. HMRC are able to review everything to establish if you are an employee or separate director of your own company. As an outline, here is a list with some of the factors that could indicate whether your contract is inside or outside of IR35.

- **Employee benefits** – As a contractor, you are not entitled to employee benefits such as training courses, holiday and sick pay, annual staff parties and pension contributions

- **Financial aspects**– Workers that are permanently employed by a company will very rarely be taking a financial risk to be at work. However, being a separate entity means that contractors may have to purchase their own equipment, which depending on the length and rate of the contract in question could leave you out of pocket
- **Freedom** – Are you free to work on your own, or are you managed? Contractors will generally work freely, whereas permanent employees are managed
- **Termination of contract** – Typically, permanent employees will have a notice period, but as a contractor, your client will normally have the option to terminate the contract with immediate effect.

## CAN I COMPLETE A CONTRACT IF I AM INSIDE IR35?

If the contract is inside of IR35, you are still able to complete the contract yes. However, you must declare that your contract is caught by IR35 and you will not be entitled to the same tax planning opportunities that contractors who are outside of IR35 would be.

If IR35 applies to a contract, as the director of your company or member of your partnership, you must:

- calculate the deemed employment payment and pay any tax and National Insurance contributions due, at the end of the tax year
- account for those payments correctly
- reassess the IR35 position if your contracts vary or change
- take into account the deemed employment payment when paying Corporation Tax, making distributions or operating the **Construction Industry Scheme (CIS) regime**

You'll also need to report information about IR35 on your **Self-Assessment tax return** which our Tax specialist will be able to assist you with. Your intermediary must also **operate PAYE** on any salary or wages it pays to you during the tax year.

## IF I AM INSIDE IR35, SHOULD I USE AN UMBRELLA COMPANY?

There are, of course, fewer benefits working through a limited company when operating inside of IR35; one example would be that you can't take dividend payments from your company. However, there can be fewer burdens, and some schemes still apply when working inside IR35, for example:

- The Flat Rate VAT scheme could increase your take-home pay
- HMRC will give you a 5% tax relief on your income which is intended to help with the administration costs of your company

Once your limited company is set up, you can use the company for your next contract too, which could be outside of IR35.

Although this is the case working through an umbrella company can have its advantages. You will:

- Be an employee of the umbrella, so IR35 does not apply
- You can claim tax-reducing expense (except travel and subsistence where you are under supervision, direction or control in the way in which you carry out your contract)
- They will calculate and pay your tax contributions to HMRC

If you decide that working through an umbrella may be best for you, our sister company [SmartWork](#) are here to offer you support and guidance in doing so.

In a similar fashion to the rules around IR35, deciding which option would be best for you again depending on your circumstances, and preferences.

## **CALCULATING YOUR TAKE HOME PAY INSIDE IR35**

It is always challenging to give you an exact take-home pay figure as there are so many factors to consider, such as:

- If you're registered for the Flat Rate VAT Scheme
- If you expense the whole 5% tax relief for operating costs, if you choose not to, you'll be liable for a small amount of corporation tax on the difference.
- If you have a pension and how much you pay into it
- Expenses that you have incurred to carry out your contract, such as travel costs except where it is automatically assumed you are under supervision, direction or control

However, as an outline, when working inside IR35, you would need to pay full income tax and National Insurance on your entire salary.

At the end of the tax year, you will need to work out your 'deemed payment'. In a nutshell, this is your turnover, minus your 5% allowance for running costs of the company.

If you have any allowable expenses such as travel, pension contributions, direct training and umbrella/accountancy fees, these would be deducted before turnover is calculated.

Once you have calculated your turnover minus 5%, you will need to take into account any salary or Employers NIC paid throughout the tax year. If you're left with a deemed payment figure higher than zero, you will need to pay further tax on this amount to HMRC.

The above may seem daunting; however, that is what your personal accountant at MyAccountant is here for; to assist you and ensure your business and accounts are running effectively.

## **WHO IS RESPONSIBLE FOR ENSURING CONTRACTS ARE IR35 COMPLIANT?**

As the director of your limited company, it is you, not your client, that is responsible for ensuring that you are complying with all relevant legislation, including IR35.

With this in mind, it is of vital importance that you are knowledgeable around the legislation, and we recommend that you approach a professional advisor for contract reviews

If you would like contact details to an advisor, we can provide details of advisors who specialise in this service.

## **WHO CAN COMPLETE IR35 CONTRACT REVIEWS?**

With HMRC increasing their activity where IR35 investigations are concerned, it is now more important than ever for a contractor to be confident that they are working in the correct way.

When required and requested, we will be able to get you in contact with our preferred IR35 contract review specialists who will be able to carry out a full assessment.

You must always consider IR35 on each separate assignment and at intervals during the assignment for complete security and as part of your responsibilities as a director.

For more information on IR35 or our services, please call us on **0800 917 9100**