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Understanding IR35

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IR35 is the shorthand name for tax rules concerning the provision of personal services through intermediaries.

These rules came into effect on 6 April 2000, but they were significantly amended from 6 April 2017 for contracts involving public sector bodies.

There are now two different applications of IR35 – for the private sector, and for the public sector. HMRC also refers to circumstances which may fall within IR35 as “off-payroll working”.

The Revenue is currently consulting on how to change the way IR35 is applied in the private sector, to align with the public sector rules.

These changes are likely to take effect from 6 April 2019, but that commencement date is not certain.

When does IR35 apply?

IR35 may apply when you provide personal services to your customer through an intermediary.

This is usually a company which you control, but the intermediary could be a partnership or another individual acting as an agent.

There may be more than one intermediary in the chain between you and your customer, such as one or more employment agencies.

The law requires you to imagine that you are working directly for your customer, ignoring the intermediaries in the chain.

Looking at the responsibilities and obligations under the hypothetical contract between you and your customer, would you be classified as an employee of your customer?

If your relationship with your customer looks like employee and employer for income tax purposes, then IR35 applies.

If the relationship looks like a self-employed contractor and a customer, then IR35 doesn't apply.

IR35 is a contract-by-contract test, so you may have different relationships with different customers.

How to test for IR35

There is no single test for being outside IR35. It's a combination of factors which, if looked at overall, show you operate as a self-employed individual rather than an employee.

You may be a director and an employee of your own company, but that's irrelevant for testing your status for IR35.

The questions to ask in relation to your contract with your customer are:

What are the obligations of both parties?

Employers have an obligation to provide continuing work for the worker, and to pay the worker even if there is no work. The employee has an obligation to perform the work. This is referred to as a mutuality of obligation.

In a self-employed relationship, there is no continuing obligation on either side to offer work or perform the tasks.

If you can decide from one small project to the next whether to accept the work and your customer can decide whether to offer you work or not, there's no mutuality of obligation.

Are you in business on your own account?

Do you have benefits and responsibilities similar to an employee, such as sick pay, holiday pay, reserved parking place, rights of dismissal or responsibility for other employees?

If you have several different customers, particularly concurrently, this is a good indicator of self-employment.

Do you have the right to send a substitute?

This is a crucial test. You don't actually have to send a substitute to perform the work, but you should have the right to send someone of equal competence, although your customer can have the right to veto your choice of substitute.

Can you hire others to help you?

If you are not providing a personal service you are not within IR35.

Do you take on financial risk?

This can be indicated by:

- an obligation to correct work in your own time and at your own cost
- being paid according to the task completed
- being paid only on submission of an invoice
- having professional liability insurance to cover any defects in your work.

Do you provide significant tools or equipment?

Using equipment provided by your customer doesn't make you an employee, but providing a significant amount of equipment yourself is a good indicator that you are independent and self-employed.

Who controls when or how you achieve the task?

Control is not always relevant, particularly for highly skilled professionals.

However, for an employment relationship to exist the employer must have control, or the right to control, the employee.

Checking your employment status

You can use HMRC's Check Employment Status for Tax (CEST) tool online, which will tell you whether your working arrangement is within IR35, outside IR35, or in around 15% of cases – that it can't decide.

If the CEST tool can't decide, you can ask HMRC to provide a view as to whether a particular contract falls within IR35 by sending them a copy of the contract and other relevant documents. However, you must use the CEST tool first.

The Institute of Chartered Accountants in England and Wales has said the CEST tool is not suitable for judging whether private sector contracts are within IR35.

The CEST tool also has limitations when applied to public sector contracts as it doesn't take account of the mutuality of obligation test as described previously.

What if IR35 does apply?

The actions you or your customer must take if IR35 applies depends on whether your customer is a public sector body – such as an NHS trust, the BBC, and government departments – or a private sector organisation. Your customer will know whether it's a public sector body.

Private sector

Your company is responsible for judging whether IR35 applies to each contract you perform.

Where IR35 does apply, the net proceeds of the contract, after allowable deductions, should be extracted from your company as salary paid to you and taxed under PAYE.

We can help you with that calculation as it is not straightforward.

HMRC can enquire into your company's tax affairs at a later date and challenge your decision about IR35.

If the Revenue believes you have made the wrong decision on IR35, your company may have to pay more tax. If it has no funds, HMRC can issue a tax demand to you personally.

Public sector

The decision as to whether you're within IR35 should be made by your customer: the public sector body.

It should use the online CEST tool to reach a conclusion about IR35 for each individual worker, but many public sector bodies are making blanket decisions covering large groups of workers, which runs contrary to HMRC's guidance.

If your customer decides that IR35 does apply to your contract, it should instruct the fee payer in the chain (normally the employment agency) to deduct income tax and employee's class 1 national insurance contributions (NICs) from the amount invoiced by your company.

It should not deduct employers' class 1 NICs from the invoiced amount, but some agencies are deducting employer's NICs in contravention of the rules.

No other deductions are permitted from the amount which your company invoices.

If the public sector body decides you're outside IR35, the fee payer can pay your company's invoice with no tax deducted.

However, the fee payer continues to be liable for PAYE and NICs due should HMRC decide that the IR35 decision made by the public sector body was incorrect.

You can't appeal the IR35 decision made by your customer, but you can ask it to state its reasons in writing.

Need further help?

There is far more to IR35 than outlined in this brief guide. For example, there are separate rules about claiming traveling expenses.

Each contract you work will be different, so you will need to make a separate IR35 decision based on each one.



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