



IR35

What is IR35?

Introduction

IR35, also known as the Intermediaries Legislation and more recently 'off-payroll working', is tax legislation which came into effect in April 2000. It is designed to combat tax avoidance by individuals who supply their personal services to clients via their own Limited Company business, commonly referred to as a Personal Service Company (PSC).

In essence, if a contractor is completing work for a client and they look and feel like they are an employee of the client, they are 'caught' by the legislation. This is commonly referred to as 'inside IR35' and they are therefore deemed a 'disguised employee' by HMRC.

If caught by IR35, any income received by the PSC for that assignment should be subject to full Income Tax and National Insurance Contributions (NICs) as if they were an employee, also known as a Deemed Payment, rather than, for example, being able to take dividends from the business as a shareholder. The financial impact of IR35 can be substantial, reducing their net income significantly.

There are many factors to consider when assessing an IR35 status, such as;

- Control the client has over you and your work
- Right of Substitution
- Mutuality of Obligation
- Financial risk and if you're part and parcel of the client's organisation.

What it was before

Prior to April 2017, it had been the contractor's obligation to make IR35 determinations and any tax liabilities for failing to operate IR35 correctly also lay with the contractor and their Limited Company.

What it is now

In the Public Sector from 6th April 2017, the determination for IR35 shifted to the End Client (the company at which the contractor carried out the work) and the liability falls on the fee payer (the company in the supply chain that actually pays the Limited Company, often a Recruitment Agency). The same changes came into effect in the Private Sector on 6th April 2021.

If the end client determines a role as outside of IR35 then a contractor can continue the contract as normal with gross payments being paid into the Limited Company. However, if a client determines an assignment as inside IR35, HMRC will no longer allow gross payments into a Limited Company and PAYE Tax and National Insurance must be deducted at source.

Who isn't impacted?

All contractors and clients in the Public Sector fall under the above changes, however in the Private Sector this change only impacts medium and large business and not those deemed as 'small' under the Companies Act 2006. This relates to the ultimate End Client and not the Fee Payer or the Limited Company.

A 'small' business is one that satisfies two or more of the following:

- An annual turnover not exceeding £10.2m
- A balance sheet total not more than £5.1m
- An average of no more than 50 employees in that financial year

What factors determine it?

1. Control & Direction

One of the most important determinants of IR35 status revolves around the extent to which a client controls where, when and how an individual performs his work.

In most cases where professional services are provided, it is important that a contractor can demonstrate a certain amount of autonomy in the way they undertake a project.

Employees are typically under the direct supervision and control of their employers, however the truly self-employed will have more influence over how they complete the work they have been hired to do.

For a contractor to successfully demonstrate that they are not under the direct supervision and control of the client, both the written contract and working practices must show that the client has no influence over how the contractor performs his services, nor the manner in which they are performed.

2. Personal Service / Substitution

The right to provide a substitute in a contractual agreement has long been deemed to be an important factor when demonstrating that a contract assignment falls outside the scope of IR35.

An employee provides his/her personal services to an employer (client), whereas a business would provide its services to a client, rather than the exclusive services of an individual.

The right to supply a substitute must be a genuine one, otherwise, HMRC may conclude that the clause is a fetter. The individual should be able to show how a substitute could be used in practice, however employment status experts say that simply having the right to provide a substitute is a strong pointer to being outside IR35, even if the right is never exercised.

The company should always pay for any costs relating to providing a substitute worker, should the need ever arise and it should also provide any training, and make all arrangements for bringing the substitute on site.

3. Mutuality of Obligation

A mutuality of obligation exists when an employer expects a worker to undertake work when asked to do so, and the worker expects to be given work on a constant basis. For self-employed people, they would expect a client to hire them to undertake a specific task, with no expectation of further work being provided after the initial task expires.

For a contract of service to exist at all, there must be what is known as an 'irreducible minimum of mutual obligation' – that the engager is obliged to remunerate the worker, and the worker is obliged to provide his/her skills.

Problems may arise if, for example, an end client cannot terminate a contract for services immediately, but instead has to provide notice. Again, if a contractor has a 'rolling' contract with a client, rather than a fixed-length contract, this could also indicate that a mutuality of obligation exists at the end of the initial contract period.

4. Provision of Equipment

Does the individual use equipment provided by the client, or do they use their own?

5. Financial Risk

How much financial risk does the individual undertake in their work? If all the risk lies with the client, then this is an indicator of 'employment' rather than 'self-employment'.

6. Basis of Payment

The regularity of payment may have some influence on IR35 status. Self-employed people are often paid by the job, rather than a fixed hourly/daily rate.

7. Part & Parcel

To what extent has the individual become part of the organisation?, i.e. do they have access to staff facilities, attend staff meetings, attend staff social events or receive staff benefits?

8. Exclusive Service

Does the individual work for just one client, and have their contracts been renewed many times? The self-employed typically work for a number of clients at once.

9. The intention of the Parties

Even if no formal written contract exists, HMRC would want to determine what the true status of the relationship between the parties is – one of employment or self-employment.

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