Genie Accountancy

Knowledge, Experience, Support

A short guide to IR35

Worried about receiving a surprise tax bill?

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With Genie Accountancy you will receive access to OpenBooks, a cloud based bookkeeping package. No more reconciling laborious spreadsheets! You can access your accounts and run your business from anywhere at any time of the day, you can even view your account and send us expenses via your smart phone!

From a single easy to use, dashboard you can generate and view interactive reports in real time, anytime. The system is safe and secure and has no installation costs or IT maintenance required.

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1.0 Introduction - Scope of IR35

IR35 Legislation was introduced in 2000 by HMRC in order to tackle what they regarded as "disguised employees", with an aim to increase tax collected from those individuals who set up a business in their own account.

The Legislation applies to all individuals providing their services through an intermediary (i.e. their own Limited Company) where the income received for performing the services would have been treated as employment income had the contractor been directly contracted by the end client on a personal basis.

When reviewing IR35 status cases it is necessary to construct a hypothetical contract between the worker and the end client. Where an agency is involved there is often no contractual relationship between the worker and the end client and in some cases there can be multiple parties involved and all the terms and conditions between all of the parties need to be considered.

It is necessary to consider IR35 each time a new arrangement or contract is entered into. IR35 relates to the "relevant engagement" and it is possible to provide services to the same end client on two projects, one of which is inside and one outside of IR35.

1.1 Does IR35 apply to you?

IR35 is complex and often contentious; status cases are determined through case law interpretation, there is no statutory definition. The emphasis of the courts to particular factors has over the years changed, as has HMRC's interpretation of the findings.

When determining IR35 status it is vital the written terms of the contract, the actual relationships between all parties are considered as well as the working practices.

Essentially there are three requirements for IR35 legislation to apply and all three have to be satisfied before the contractor can be deemed to be an employee and fall into the IR35 rules.

1.2 Substitution

As an employee, you would be obliged to perform the services for your end client personally. A contractor should have the freedom to choose whether to undertake the task himself or hire somebody else to do it.

The right of substitution is a fundamental status test and if it is genuinely possible to send a substitute, you cannot be deemed to be employed. The 1968 Ready Mix Concrete case recognised that the "Freedom to do a job by one's own hands or another's is inconsistent with a Contract of Service (employment)."

Any contract should not unreasonably "fetter" the right to send a substitute. In the Express and Echo case of 1999, the courts agreed that it was acceptable for the end client to expect the substitute to be "suitable" and equally qualified and skilled.

A contract has to contain a genuine right of substitution clause, any clause that says substitution is "allowable" can not be relied upon as the end client can revoke this.

1.3 Direction and Control

Direction and control concern how, when, where or what is to be done. The more of these elements that the end client controls the more likely the contractor will be found to be an employee.

If your client can determine your priorities, control when you undertake the work and dictate the location and time of your work you may be deemed to be an employee. There may be commercial reasons why you can only attend premises at certain times – eg security etc. and the direction over location can be neutral.

How the project is to be completed is a strong indicator of the IR35 status. If the end client prescribes how the task is to be undertaken and the work to be carried out, employment may exist. Regular updates are expected and are not deemed as control or direction. Ideally your contract should clearly state that the client has no right to control or supervise and that whilst they can make reasonable requests, you have no obligation to follow them.

1.4 Mutuality of Obligation (MOO)

MOO is complex and the internal guides for HMRC suggest that until 2001, Inspectors were advised not to raise the issue because of its complexity.

Case law highlights that for a mutuality to exist, and therefore employment, there needs to be a continuing obligation on the employee to provide his own services, and on the employer to provide work – or if there is no work, to at least pay the employee. Clearly therefore if there is no expectation of continuous work, no payment is made for periods when work is not offered, there is no obligation to find or accept work either during the contract period or afterwards, MOO cannot exist. Notice periods in contracts are inconsistent with MOO. “Rolling contracts”, or indeed contracts that are continually renewed could fail this test.

1.5 Other factors to be considered

There are numerous pertinent factors that may be considered in individual IR35 status cases.
They can include:-

Financial Risk

A contractor who risks his own money by buying assets, bearing the running costs of the business and paying for overheads is more likely to be viewed as being business on his own account. They are costs and risks that are not borne by employees. The risk of not being paid for an invoice, quoting a fixed price for a job that then over or under runs are also not indicators of employment. Correcting faulty work at your own cost and purchasing Professional Indemnity insurance are signs of being in business not employment.

Provision of Equipment

The provision of equipment by the contractor may be an indicator of being in business but if the contract is for a skills only assignment it may be of limited value. An end client's provision of specialist equipment is acceptable.

Basis of payment

Employees tend to be paid a fixed rate, weekly or monthly and are also being paid overtime. HMRC contend that contractors paid on a fixed hourly or daily rate are therefore employees. Case law does not support this.

Freedom to offer services to others

The contractor, whilst engaged on a project, should be free to undertake other services for others and to use his skills as he sees fit. Having other business streams is most helpful in showing that a contractor is in business on his own account.

Part and parcel of the Organisation

The contractor should not be seen to be an integral part of the end client's organisation. Recent case law has shown that where an individual is integrated into the workforce and is undertaking the usual work of a business, as opposed to be being brought in to undertake a project or for specialist skills , IR35 is likely to apply. To this end the contractor should not use any benefits provided to employees such as a subsidised canteen, gyms, attend Christmas parties.

Highlight...

Contractual indicators alone are not enough to determine IR35 status and alongside these any review should also examine the working practices and relationships between all parties. It is therefore important that each assignment review be carried out by independent professionals who know and understand not only the IR35 legislation but can also interpret relevant case law precedent correctly and be fully up to date with HMRC's processes and procedures. A good record of defending IR35 investigations is helpful too.

We recommend our partners, Bauer & Cottrell, led by Kate Cottrell a member of the IR35 Forum and advisor to HMRC. We work closely with them to assist our contractors.

Left in the dark about current legislation?

Not with Genie Accountancy

Genie Accountancy provides a truly **pro-active** service so that we can ensure that you and your business reach its full potential.

Unlike high street accountants we only deal with contractors which means we can ensure you are armed with the very best knowledge and advice to make your decisions based on up to date legislation and the latest thinking.

Our service levels are second to none. We are committed to providing a friendly pro-active service, offering jargon free advice and total support. We promise to maintain our accountant to client ratio at levels below the industry average to ensure we can deliver a truly exceptional experience.

We will also meet with you to discuss the accounts and your business's performance

1.6 HMRC Approach since May 2012

IR35 has received increased attention following the Office of Tax Simplifications (OTS) report on Small Business Taxation and IR35. The Government decided to retain IR35 but to improve administration of the legislation with the assistance of three new specialist offices.

Following high profile cases of individuals in senior positions within the public sector operating through personal service companies, the Government also announced guidance for Public Sector workers.

1.7 Business Entity Tests

May 2012 saw the introduction of the business entity tests, which are currently being piloted by HMRC. They seek to establish whether a contractor is at high, medium or low risk of a status investigation.

The tests are part of HMRC's risk processes only and the key issue to remember is that these tests are NOT tests to decide IR35 status. This is because the IR35 legislation has not changed. There will be individuals that are low risk who are inside IR35 and individuals who are high risk who are outside IR35 and vice versa. It is still necessary to consider IR35 status on an engagement by engagement basis and even if there is HMRC agreement that the risk is low following the opening of a review there is still a legal requirement to apply the IR35 rules to any contract within IR35.

HMRC have undertaken that where a business takes the tests (which are voluntary) and provides satisfactory documentary evidence to support their "low risk" score they will close a review, with a condition that as long as the information provided was correct and circumstances do not significantly change, they will not review the business again for the next three years.

1.8 Guidance for Public Sector Workers

Following high profile cases of individuals working in the public sector, via their own companies the Government used guidance that all board members and those with significant financial responsibility should be put on the payroll.

The guidance has extended to other individuals, engaged off payroll where they earn in excess of £220 per day, under contracts lasting more than 6 months. Generally this means that contracts will be changed to include clauses giving the right to the engager to seek assurance and information and evidence to show that income is being treated correctly for tax and NI purposes, especially with regard to IR35.

Any contractor failing to comply with such a request could find his contract terminated.

A contractor will be expected to take the business entity tests. If they are found to be at low risk, they will ask for a written declaration that you evidence to support your position. If at medium or high risk, the contractor will be asked to provide evidence of an IR35 contract review to support their status. Alternatively they can show that the IR35 legislation has been applied to all earnings from the contract.

1.9 Guidance for Public Sector Workers

HMRC have pledged to increase the number of status reviews as part of their new approach. Figures received by Bloomsbury Publishing, via the Freedom of Information Act, support the view that the Government and HMRC have re-launched their IR35 attack and many commentators, including Kate Cottrell believe the number of investigations will continue to increase.

Investigation Statistics

Tax year	Investigations Opened	Tax yield from IR35 Investigations
2006/07	158	£1,906,619
2007/08	104	£1,730,640
2008/09	25	£1,430,358
2009/10	12	£155,502
2010/11	23	£219,180
2011/12	59	£1,250,000
2012/13*	600 Private sector and 2,400 Public Sector Contractors	?

NB. The tax yield recovered each year is not in line with the number of enquiries opened in the corresponding year, as investigations might begin in one year and be concluded in another. * Figures are estimated based on comments by HMRC.

2.0 What happens if the contract is found to be inside IR35?

If caught by IR35, HMRC sets out specific rules on how to calculate tax payable. 95% of turnover will have to be treated as a deemed salary, subject to certain qualifying expenses, with 5% of turnover being set aside as an allowance for the costs of operating a company.

The following expenses are qualifying deductions in calculating the employee's deemed salary:

- Travel, Mileage, Accommodation & Subsistence costs that you would have been able to claim as an employee.
- Childcare
- Employer Contributions to an approved Pension Scheme
- Employer National Insurance Contributions
- Approved Professional Subscriptions
- Professional Indemnity Insurance

If operating inside IR35 a contractor chooses not to apply the deemed salary calculations, HMRC have the right to determine the deemed salary by reference to the above rules and raise assessments for the additional tax and NI – penalties and interest may also be charged as a result.

An alternative to operating the IR35 rules through a Limited company is to use an Umbrella Company such as Genie Umbrella.

For a competitive fixed monthly fee of £99 + VAT we will:

- File an Annual Return with Companies House
- File Statutory Accounts in Companies House Format by the due date to avoid late filing penalties
- File Accounts and CT600 with HMRC by the due date and ensure that the Corporation tax is paid
- File a Self Assessment Tax Return by 31 January each year
- File VAT returns as appropriate and ESC Sales listing if necessary
- Prepare payroll information on a monthly basis, ensure PAYE is paid on time and undertake the completion of Year End payroll reports such as P35, P14's, P60's and P11ds
- Provide access to our accounting portal that allows you to maintain accurate books and records for your company in line with your responsibilities as director and gives you a real time access to your financial situation
- We will review your entries on a regular basis and provide pro-active tax planning advice to maximise earnings
- Your dedicated accountant will be here to answer all questions by phone, email and face to face meeting if pre - arranged at no extra cost
- We will undertake tax planning with you on a regular basis to ensure you are working efficiently
- We can provide support and guidance in relation to IR35 queries
- We will contact you regularly with updates and newsletters to keep you updated with any changes

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