

IR35: TAX TIPS FOR CONTRACTORS

2019/20

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About This Guide

Off-payroll working and IR35 is an area that creates a lot of discussion amongst tax advisers and taxpayers, and some confusion too. The rules are anti-avoidance measures which are designed to level the playing field where a worker provides services to an end-client through an intermediary, such as personal service company, and the nature of the engagement is such that were the services provided directly to the end client, the worker would be an employee of the end client.

In this special report, Sarah Bradford explains when the off-payroll working rules (IR35) apply, the reformed rules for off-payroll working in the public sector, and the extension of these rules to the private sector from April 2020. She also gives some useful pointers and tips to make sure contractors don't fall into the common IR35 traps.

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IR35 At A Glance

The IR35 rules are anti-avoidance rules, which were introduced with effect from 6 April 2000 in respect of services performed on or after that date. The measures were introduced to target workers predominantly in the IT industry who resigned from their job on a Friday and started in a self-employed capacity on the following Monday in essentially the same role. However, their application is not limited to the IT industry – they potentially apply to any worker who provides his or her services through a personal service company or other intermediary.

The name ‘IR35’ is taken from the number of the HMRC (then the Inland Revenue) press release in which the measures were announced. The rules are also referred to as the ‘intermediaries’ legislation’ and, more recently, the off-payroll working rules. In this guide, these terms are used inter-changeably.

The IR35 rules target the perceived loss of tax and National Insurance to the Exchequer that may arise where a worker provides his or her services to a client through an intermediary such as a personal service company and, in the absence of the intermediary, the worker would be an employee of the client. So, instead of the worker paying PAYE and Class 1 employee’s National Insurance contributions, and the client paying employer’s National Insurance, the client makes a gross payment to the personal service company. The worker then extracts profits from the personal service company, typically in the form of a small salary and dividends and paying little or no National Insurance (as no National Insurance is payable on dividends). However, it should be noted that the personal service company will be liable to pay Corporation Tax on its profits. The IR35 rules seek to claw back the tax and National Insurance that would otherwise be lost as a result of providing services in this way.

The IR35 rules bite where, but for the existence of the intermediary, the worker would have been an employee of the end client. This is determined by applying the usual employment status tests (discussed at Section 7 below).

Essentially, the effect of the IR35 provisions is to try to replicate the tax and National Insurance position that would have arisen had the worker provided his or her services to the client directly as an employee. This is achieved by regarding the earnings of the intermediary as the income of the worker and calculating a deemed payment, which is treated as having been paid to the worker on 5 April at the end of the tax year. The worker must pay income tax and employee’s Class 1 National Insurance on the deemed payment and the intermediary must pay employer’s Class 1 National Insurance. Certain deductions are taken into account in calculating the deemed payment.

When IR35 was introduced, it was the intermediary, such as the personal service company, which was responsible for determining whether IR35 applies. The rules were reformed from 6 April 2017 where the end client is a public sector body. Under the reforms, responsibility for deciding if the off-payroll working rules apply moved from the intermediary to the public sector body. Where the engagement is within the rules, the fee payer must deduct tax and National Insurance from payments made to the intermediary. These rules are discussed in Section 21.