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IR35

The New Rules

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What is IR35?

IR35 was introduced in 2000 to determine the employment status, for tax, of individuals who provide their services through their own limited companies.

All too often Independent contractors, working through their own limited companies, are entitled to receive advantageous tax treatment on their earnings, in that they can claim expenses and take the bulk of their profit by way of dividends.

On the other hand workers who are considered to be working as “disguised employees” of the end client are only entitled to receive income that is taxed on a PAYE/NI basis.

Since 2000 the IR35 rules have been largely ineffective, because in the private sector, it is the contractor who determines their own individual IR35 employment status. Not surprisingly, HMRC believe there is widespread non-compliance with the rules, resulting in a tax shortfall to HMRC.

In April 2017 the government moved the goal posts by gaining the use of IR35 in the Public Sector. As a result, the Civil Service; Local Government, NHS trusts and others found that they had to review all their contractors contracts; and bring many inhouse as employees.

Where to now

In late summer 2019 the draft legislation is being released to cover the private sector; for implementation in April 2021.

Under the draft legislation all companies must take “reasonable care” when assessing if roles are inside or outside of IR35. Taking a blanket approach to assess all these rules won’t deliver this. Firms must show they have carried out individual assessments.

The potential financial penalties can be significant if incorrect steps are taken; but here at Goddards we can help.

What to do

The following factors will help demonstrate that you are not a disguised employee onsite and caught by IR35.

1. Ensure your contracts are accurate and consistent

It makes little sense having a contract that states that you will be subject to the control of the client, or that the client's processes and procedures will apply to you when they don't in practice. Also, make sure that the contract between the agency and the client does not contain anything that contradicts your contract with your agency.

It would make good practice, if you work through an Agency, to ensure the client is in agreement with the key IR35 clauses contained within the contract. If the contract contains a substitution clause, but the client says that this isn't workable, this could make the contract a sham meaning that you would be unable to rely on such clauses.

We always recommend that you provide a copy of your contract to Legal Services before you sign, in order to ensure that the contract supports your position as a true independent contractor.

2. Make sure your client thinks the same way you do.

If your client sees you as an extension of its own workforce, the company is more likely to treat you as an employee. Make sure they know that you have been contracted for a specific reason and that they treat you as an independent of their organisation throughout your assignment. If they integrate you into the organisation in a similar way to how they integrate employees, this will be damaging to your IR35 Status.

This is particularly important when your client representative (ie. The person who would liaise with HMRC in the event of an IR35 enquiry) is different from the individual who hired your services or worked with you day to day at the outset of the project. If +necessary, provide a copy of your contract to the client representative or even agree a “working practices statement” which sets out how you intend to work/be treated whilst on an assignment with the client to avoid any misunderstandings.

3. Demonstrate that you are treated differently from your client's employees

Different pay and benefits alone will not be enough to support your status as an independent contractor. Flexible working, working on multiple assignments for different client, providing your own equipment, working on a specific package of work for a fixed fee and/or a fixed period are all good ways of showing that you are truly independent.

4. Provide services on short term project basis assignment

Whilst providing services on an assignment that lasts a number of years, will not bring you within IR35, it would make good practice to work on short-term projects. By doing so, you will build a client base, which can make it difficult for HMRC to say you are a employee of one of your clients.

5. Working as part of a team does not automatically render you a disguised employee of the client

It is essential however, that you can separate your work from the employed workforce and agree the scope of the work you undertake at the outset of the assignment and reference this within the contract. Working alongside employees doing similar work and

being continually allocated further work by the client, particularly without putting in place additional contracts, could show that you are doing the role of an employee and being treated as an employee.

If further work comes up which you are happy to do, make sure you agree a new contract before you start working on it. This also gives you the opportunity to renegotiate your rate.

6. Provide a substitute

Whilst it is not essential that you provide a substitute and you only need to show that you have a valid right to provide a substitute, having a substitute clause within the contract will only benefit you if you can persuade HMRC that this right can be activated in practice and your client will accept a substitute.

Not only does providing a substitute give you unequivocal evidence that you are not obliged to offer a personal service, and therefore cannot be a disguised employee, it can also enable you to profit further from the assignment by supplying cheaper labour to perform the services on your behalf. It could also give you the flexibility to work on another contract with a different client.

7. Project based assignments are significantly better than period based ones

Being engaged on a specific project enables you to quote a fixed fee and work flexibly as long as deadlines and project completion dates are met. It also indicates that the work will come to an end at some point. Being engaged on an ongoing basis may indicate that you are only there for as long as as the client requires or until the client recruits a permanent employee to do your job. This could look like the client is treating you as if you were that individual until someone permanent comes along which can potentially make you a disguised employee.

8. Manage your own assignments

As an independent contractor, you should determine the hours required to complete the work. It is important that you take control over managing your assignments and don't rely on being allocated work. This will also enable you to quote a fixed fee for the project and/or undertake work for other clients alongside your assignments.

You should also be able to demonstrate that you retain the discretion to determine where to perform the services from. If the client is controlling what work you do, when you do it, where you do it from and how you do the work, you are likely to be viewed as a disguised employee.

9. Demonstrating that you are exposed to financial risk

HMRC like to see Independent Contractors showing a lack of financial security and from time-to-time incurring losses, even though this doesn't make good business sense. This could involve you showing that you have financial risk in terms of bad debts, rectifying work at your own cost and investing in your company, all good "badges of trade". Keep records of any such instances occurring as they will prove useful in the event of an IR35 enquiry.

10. Working for multiple clients and investing in your own company is a good way of demonstrating that you are in business of your own account

The more clients you work for, the easier it is to demonstrate that you are self-employed, whereas only having one client as your sole source of income for a lengthy period of time may suggest that you are working on an ongoing basis, similar to an employee. To counteract this, pay for your own training and provide as much of your own equipment as possible and pay for them through your business to ensure they are properly accounted for.

What about Recruitment Businesses?

Unfortunately the consultation document has created a confused liability picture for clients and their agencies.

The consultation document suggests that intermediaries in the supply chain will have an obligation to pass the status determination decisions down the supply chain; and if HMRC identifies a tax shortfall, they will look in the first instance, to the intermediary that they believe has failed to fulfil its statutory obligation.

In addition, the consultation document is proposing that in the event that HMRC fails to recover any tax shortfall from the failing intermediary, it will then look to the Agency that has the contract with the end client.

For further information about Goddards Accountants, please call us at our offices:

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