

# IR35

## Individuals, companies and IR35

# IR35 – Outline of the presentation

- **Definition**
- **Rules**
- **Employers**
- **Example**
- **Income Shifting**
- **HMRC - Summary**

# IR35 - Definition

Legislation for IR35 came into effect from 6<sup>th</sup> April 2000

The legislation is designed to harmonise the tax and NIC paid by certain types of people/businesses in line with employed staff. It is designed to increase the revenue from the service industry where previously it was tax efficient to distribute income as small salary and a much larger dividend.

IR35 applies when an individual provides a service to a client through an intermediary, i.e. through a partnership, limited company or agency

The question that is asked is

“If the intermediary did NOT exist would the work for the client business look like direct employment”

From 10<sup>th</sup> April 2003 domestic workers also fell within this law including nannies butlers and housekeepers.

# IR35 - Definition

Could the answer to these two questions be “yes”

1. Would the individual be regarded as an employee if they worked for the client directly and not through the intermediary
2. Does the individual have the rights to receive other payments from the company/partnership that is NOT employment income – i.e. dividend

# IR35 - Definition

If an individual could answer "yes" to the following questions, they may fall within the IR35 rules.

- Is the contract set hours, or a given number of hours a week or a month?
- Does the contract specify the work is done by a named individual rather than allowing for the subcontractor to provide another person to do the work?
- Is the contract supervised so that the individual is told what to do, when to do it or how to do it?
- Is the contract paid by the hour, day, week?
- Does the individual get overtime pay?
- Does the individual work at the premises of the contractor, or at a place or places they decide?
- Do you generally work for one client at a time, rather than having a number of contracts?

# IR35 - Definition

If an individual could answer "yes" to the following questions, they may fall outside the IR35 rules.

- Is the contract for a specific project of finite duration?
- Does the sub contractor decide how, when and where to carry out the services?
- Can the sub contractor make a loss on the contract?
- Does the sub contractor provide the main items of equipment needed to do the job for the client, not just the small tools many employees provide for themselves?
- Can the subcontractor hire other people on their own terms to do the work? Are these sub contractors paid by the initial sub contractor?
- Does the subcontractor correct unsatisfactory work in their time and at their own expense?
- Does the subcontractor have a number of customers at the same time?

## IR35 - Definition

- Non Employment income

If an individual operates through a company as a company shareholder, they have rights entitling them to receive a payment that is not employment income in the form of a dividend on their shareholding.

- If an individual is a member of a partnership, their share of profits is usually chargeable as trading income, not as employment income.
- Calculations run for the tax year and not in line with a company year.

# Partnerships

- **The rules only apply if**
  - The individual (or their family) are entitled to 60 per cent or more of the profits of the partnership, or
  - all or most of the partnership's income comes from providing services to a single client, or
  - the profit sharing arrangements in the partnership are designed to ensure that the individual receives an amount based on the payments received for their services to clients.

# Employers

- **Why should an employer be worried?**
  - HMRC deem that the contract is a method of avoiding paying National insurance contributions (NIC)
  - The contractor can be reclassified as an employer and then liable to the newly established employees NIC both the ERs and EEs.
  - HMRC can go back over 6 years and further if they can prove it was a situation designed to evade paying NIC.

# Example

- **Deemed Salary Calculation**

Income		X
Less: permitted deductions		
Salary & NIC paid		
Employer pension contributions	X	
S336 ITEPA 2003 claims	X	
Appropriate Cap All claims	X	
Benefits in kind	X	
Statutory deductions for employees	X	
5% of gross income	<u>X</u>	<u>(X)</u>
Deemed Sch E Payment		<u>X</u>
Due by 19 <sup>th</sup> April following the end of the tax year		

# Example

- **S 336 ITEPA 2003 Claims**
  - Mileage
  - Other travel
    - Train fares
    - Air fares
    - Hotel costs
  - Low value subsistence

# Managed Service Companies (MSC)

- Now covered by the Finance Act 2007
- Requires that payments received by persons in respect of services provided through such companies, not already treated as employment income are treated as employment income and taxed
- What is MSC
  - The business consists primarily of providing the services of an individual to another.
  - The payments made equate to the majority of the turnover.
  - The way payments are made mean that there is a reduction in the PAYE and NIC paid compared to standard employment.

# Managed Service Companies

- From 6 April 2007 all payments received by individuals providing their services through Managed Service Companies will be subject to PAYE
- From the same date the cost of travel from the individual's home to the individual's place of work is not an allowable tax-free expense for workers within MSCs
- It is planned that from 6 August 2007 National Insurance Contributions will also be due on all payments received by individuals working through MSCs
- Also from August, where the PAYE and NICs debts of an MSC cannot be recovered from the company, HMRC may transfer the debt personally to:
  - The company's director; or
  - The MSC Provider
- Debts may be transferred to other third parties from 6 January 2008.

# Example of IR35 Calculation

2007/08	No IR35		IR35	
Gross Pay	8000		8000	
tax	342		342	
Employee NIC	306		306	
Net Pay	7352		7352	
Employer NIC	356		356	
Company				
Income		30000		30000
Wages	8000		8000	
Employer NIC	356		356	
Travel	2500		2500	
Pension	1500		1500	
Professional Fees	800			
Office Expenses	1000	14156	1500	13856
Profit before Tax		15844	Deemed Salary	16144
Corporation tax at 20%		3169	ERs	1832
			Tax	3149
Total Dividends		12675	EES	1574
			Net Deemed	9589
Total Income		20028		16942
			Difference	3086

# IR35 – What if the contract is within IR35

- 5 April - calculate your deemed payment.
  - [http://www.hmrc.gov.uk/leaflets/calc\\_deemptyt.htm](http://www.hmrc.gov.uk/leaflets/calc_deemptyt.htm)
- 19 April - send any tax and NICs due on the deemed payment, or a payment on account of any tax and NICs due.
- 19 May - send end of year PAYE returns (forms P35 and P14).
  - Include any deemed payment, and the tax and NICs due on it. If not final, but calculated include a covering letter explaining that the figures are provisional.
- 31 January – If provisional figures sent on 19<sup>th</sup> May, send corrected figures, and pay the balance of tax and NICs due. Interest will be payable on any additional tax and NICs due from 19 April until the date paid. Issue corrected P60s for personal self assessment tax returns
- Continue to operate PAYE and pay NICs in the usual way on any salary paid during the year, and report any taxable benefits - such as a company car - to HMRC on form P11D. The deadline for submitting form P11D to HMRC is 6 July.

# Income Shifting

- **New proposals to make it harder for smaller businesses to shift income between family members**
- **A HMRC knee jerk reaction to losing the Arctic Systems court case in 2007.**
- **An area that had exercised the minds of many tax experts**
- **The legislation has been delayed until 2009.**
- **The legislation will be directed at business where there are no genuine commercial arrangements and the division in income are undertaken for the main purpose of avoiding or reducing income tax.**

# HMRC – Where do you go?

- **Employment Status Indicator**

- <http://www.hmrc.gov.uk/calcs/esi.htm>

- **The ESI tool should not be used for determining the status of:**

- Office holders (such as company directors and other certain individuals who are appointed to a post)
  - Individuals who provide their services through a limited company (known as IR35)
  - Contracts with agencies to provide services to another person (client).

- **Employment Status Manual**

- <http://www.hmrc.gov.uk/manuals/esmmanual/index.htm>

# HMRC – Where do you go?

- **IR35 Unit**
- **HM Revenue & Customs**  
**North East Metro Area**  
**Fountain Court**  
**119 Grange Road**  
**Middlesbrough**  
**TS1 2XA**