

IR35 Guide

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This IR35 Guide contains the following sections:

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What is IR35?

IR35 is probably the most important piece of tax legislation to affect freelance contractors working in the UK. If you fail to consider IR35 and its effects you could either wind up paying too much tax or face a large and unwanted tax bill in years to come.

IR35 affects the individual contracts that a contractor works on.

If you work on a contract deemed to be Inside IR35 all billings relating to the contract (except allowable business expenses) must be paid in the form of employment income subject to full Pay as You Earn (PAYE) deductions.

If you work on a contract considered to be Outside IR35 you may set up your own limited company consultancy and receive the majority of contract income in the form of dividends. By going into business, and generating income in this way you can avoid large class 1 national insurance deductions and possibly improve your net take home pay by up to 25%.

If you would like to discuss IR35, umbrella company solutions or going into business with your own contractor limited company call an experienced Commonwealth Contractors Account Manager now on **0800 294 4388!**

Why was IR35 Introduced?

The Government introduced IR35 (Intermediaries Legislation) with effect from April 2000 in an attempt to remove the opportunity for workers to avoid employed levels of tax and national insurance by using an intermediary such as a Limited Company. The government argued that if the intermediary were removed the worker would be considered an employee of the client and therefore subject to employed levels of tax.

Prior to the introduction of IR35 any contractor could set themselves up in a limited company and benefit from self-employed levels of tax/NI. Contractors would take a small salary from the company, claim business expenses and otherwise take the remainder of contract income in the form of dividends. As National Insurance contributions do not apply to dividends the worker would pay less tax than if a normal employee of the client.

The Government estimated that it was losing a lot of money in tax revenue and decided to act with IR35.

IR35 Status

Deciding whether or not you are Inside or Outside IR35 can be very complicated as it not only depends upon the terms and conditions of the contract you will be working further to but also the actual day to day working arrangements.

You must consider IR35 when agreeing a contract. If you fail to consider IR35 and take dividends when caught you could face a very large tax bill in future years.

The Impact of IR35

Your IR35 status will have a massive effect on the way you can take contract income from your limited company. If you are Inside IR35 and considered a disguised employee of the client all contract income with the exception of site based business expenses must be subject to full income tax and national insurance deductions. If you are outside IR35 and genuinely self employed you may take contract income in the form of dividends and avoid large national insurance deductions. The tax (and, more importantly, National Insurance) savings from being outside IR35 may be as high as 25% so it is worthwhile taking the time to ensure you are outside IR35.

If you would like to discuss IR35 or contract structures such as Umbrella Companies or Limited Companies call Commonwealth Contractors now on **0800 294 4388!**

Contracts inside IR35

The majority of contracts, especially those secured via recruitment agents are normally deemed Inside IR35. If you have any hope of being considered outside IR35 you need to make certain revisions to the contract.

Inside IR35 contract income must be paid under the Pay as You Earn (PAYE) scheme. The only way to reduce the amount of income tax and national insurance payable is to claim the cost of legitimate business expenses incurred during the assignment from contract billings.

It is recommended that contractors Inside IR35 use an umbrella company structure such as Expat Advantage or Payroll Umbrella. With an umbrella company solution all you have to do is send timesheets and expenses, everything else is done for you. The umbrella company takes care of arranging contracts, raising invoices, receiving client/agency payment, processing expense claims, deducting tax and national insurance and paying net of tax into your bank account.

Contractors inside IR35 must pay Income Tax, Class 1 Employees National Insurance and Class 1 Employers National Insurance on contract income.

Contracts Outside IR35

If you work on contracts considered outside IR35 you can minimise tax deductions by taking contract income in the form of profit payments i.e. dividends. Contractors running limited companies normally set an artificially low salary (normally around £12k); claim business administration and site based expenses and take the remainder of contract income in the form of dividends. By taking contract income in this way class 1 national insurance payments are vastly reduced as national insurance is not payable on dividend income. The only national insurance payable is on salaried income.

Those outside IR35 not only benefit from reduced national insurance payments but also greater business administration expense claims and possible savings on the VAT flat rate scheme.

Where does IR35 apply?

If you run a limited company and supply contract services to a client you must consider IR35 if you hope to take contract income from the company in the form of profit payments (Dividends). If you fail to consider IR35 and you take dividends anyway you could leave yourself open to an IR35 investigation and possibly backdated tax payments in years to come. This could result in financial ruin if you don't have suitable provisions to make payment.

If you have secured a contract (or will do so in the future) and you would like to discuss IR35 and contract solutions such as Umbrella Companies and Contractor Limited Companies call Commonwealth Contractors now on **0800 294 4388!**

Determining IR35 Status

To prove that you are outside IR35 you need to satisfy certain self employment tests. To do this you need to analyse contract terms and conditions and actual day to day working arrangements. If you are not at the stage where it is possible to do this but would like a general idea you should ask yourself the following simple questions.

You must think about each contract individually as some contracts may be deemed inside IR35 and others outside IR35.

If you can answer yes to all of the following questions it is likely that you will be considered self employed:

- Can you pick and choose what hours you work?
- Can you hire another person to deliver the services for you? If so do you pay them yourself?
- Do you have the final say on how services are to be delivered?
- Are you paid on completion of a particular fixed price project?
- Can you work at whatever location you like to deliver the services?
- Do you work for multiple clients at any one time?
- Do you use your own equipment to undertake the project?
- Can you make a loss on the contract?
- Are you required to fix any unsatisfactory work at your own expense?

If you answer yes to the following questions, you may be considered employed:

- Are you told what to do by a client representative? Or how to do it?
- Do you have to do the work yourself rather than having the freedom to subcontract work to a 3rd party?
- Are you entitled to employee benefits such as a parking space or gym membership?
- Do you have to work on site to deliver services?
- Are you paid a performance-independent hourly or daily fee?
- Can you get overtime pay?
- Are you paid the same time each month? Payment at the same time if you happen to invoice at the same time can be different.
- Do you work rigidly set hours each week?
- Are you invited to staff events and functions?
- Are you run through the client's staff disciplinary / grievance procedures in the event of an issue?

Self Employment Tests and IR35 Case Law

The key to winning an IR35 Investigation is to demonstrate that you are genuinely self employed, and/or in business on your own account. However to do this is not straightforward as 'self employment' is not defined in any legislation. This means that IR35 case law must be used to determine whether or not a contractor is genuinely self employed and therefore inside or outside IR35.

When assessing IR35 status the HM Revenue and Customs look at two things, the individual contract terms and conditions and the actual day to day working arrangements. Every aspect of the engagement is assessed and self employment tests applied. If there are more pointers towards self employment than employment then the contract is considered outside IR35 and vica versa. It is therefore imperative that you satisfy as many of the self employed tests as possible and keep appropriate documentation to prove it.

For more information on IR35 and contract structures such as Umbrella Companies and Contractor Limited Companies call Commonwealth Contractors now on 0800 294 4388!

What is IR35 Case Law?

Where a law is not found in any existing legislation a judge will make a decision on a case, therefore setting a precedent. The precedent must then be applied by the courts in any subsequent cases.

The reason IR35 is not clear cut is that there are no definitions of 'employment' or 'self employment' in any tax law. The result is that definitions have been made up of Case Law, and there have been a lot of cases.

Self Employment Tests

If you hope to be considered outside IR35 you need to satisfy as many of the following self employment tests as possible. It is not enough that you satisfy the tests contractually, you must also satisfy them in actual working arrangements.

The following self employment tests have been detailed in greater depth in relation to contract terms and conditions.

Right of Substitution: If you are genuinely self employed you should be able to provide a substitute when you are not able to carry out work. You should not be providing a personal service

Mutuality of Obligation: The contractor and the client should not have an ongoing mutual obligation to one another. If you are required to undertake work offered by the client you may be seen to be employed

Right of Control: As you are delivering consultancy services you should have as much control as possible over what, when, where and how work is to be undertaken.

Termination: Having to issue notice to a client may be seen as a pointer towards employment.

Opportunity to Profit: You should be able to profit from completing the project early or reducing the cost of overheads. An employee would not have the opportunity to profit from an engagement.

Financial Risk: You are more likely to be considered self employed if you take a financial risk when undertaking a contract e.g. skills training required to undertake a particular assignment.

Length of Engagement: An employed person is likely to remain with an employer long term. If you undertake short term assignments it may be seen as more of a pointer towards self employment.

Incorporation into the Organisation: It is important to distance yourself from the client. If you are seen to be incorporated into the organisation you may well be considered employed

Employee Benefits: If the contract details employee benefits you will find it difficult to prove that you are not an employee of the client

Provision of Equipment: A self employed person would provide his or her own equipment to undertake work; an employed person would rely on the employer to provide all of the tools.

IR35 Contract Overview

Contract Terms and Conditions are the most important initial factor in determining IR35 status. If you fail to address the contract and ensure that the terms are considered outside IR35 you could leave yourself open to an IR35 Investigation and possibly a large tax bill in years to come.

An IR35 assessment should be undertaken before any contractual agreement is signed and if already signed definitely before contract income is taken in the form of dividends. It is very difficult to amend contract terms and conditions once agreed so ensure they are correct before signing. A badly drafted contract can make a genuinely self employed contractor inside IR35.

To discuss an IR35 assessment or to find out about Umbrella Companies or going into business with your own Limited Company call Commonwealth Contractors now on **0800 294 4388!**

Agency Terms and Conditions

More often than not a contractor will secure a new assignment via a recruitment agent. If you are in this situation you will find that the agency wants you to sign off on their standard terms and conditions. If you do this without assessing the contract and making any revisions where required you could find yourself inside IR35. The problem is of course that the agency will generally be unwilling to make revisions to the contract so you may be forced into taking a contract deemed inside IR35.

One of the problems with agency terms and conditions is that the agency has a standard contract between themselves and the client and themselves and the contractor. If, as a contractor you are going to make changes to your contract (Agency to Contractor) any changes really need to be replicated between agency and client. You may find this an uphill battle but a court may find contract terms and conditions artificial if they include specific clauses on one side of the agreement but not the other.

In order for a contract to be outside IR35 it must be a consultancy contract, with the service provider (contractor) retaining a large degree of control over what, where, when and how services are to be delivered. Where an agency is involved the contract will be a sub contractor arrangement. If there are any problems the client will try to claim compensation from the agency and the agency will try to claim compensation from the contractor. One of the ways an agency will try to reduce liability is by giving the client a large degree of control in the contract. This way if there are any problems the agency can say that the client had control over the contractor and therefore it is unreasonable to try to claim compensation from the agency. It is therefore very important to make back to back changes to any contract.

Right to Control

If you genuinely wish to be considered self employed and therefore outside IR35 you strongly need to consider the degree of control the client has over your working arrangements. If the client has too much control you could be considered a disguised employee and therefore inside IR35.

It is important to address the issue of control when agreeing contract terms and conditions as these dictate day to day working arrangements. The most important thing to ensure is that the terms and conditions do not imply a relationship of master and servant as this would certainly make you a disguised employee. Also consider control along with other clauses such as the right of substitution and Mutuality of Obligation.

If you have just secured a contract or you are thinking of going into business with your own limited company call Commonwealth Contractors now on **0800 294 4388**. If you're outside IR35 we may be able to advise you on going into business with your own limited company and if you're inside IR35 we can help with umbrella company solutions such as Expat Advantage and Payroll Umbrella.

Right to Control

The important thing to understand is that it is the right to control that matters, you do not necessarily have to demonstrate control in day to day working arrangements therefore agreeing suitable contract terms is very important.

Control has four main aspects:

- What work is done
- Where work is done
- When work is done
- How work is done

If the client has significant direct influence over all four the relationship is likely to be considered one of employment rather than self employment. It is normally unrealistic to think that you are going to have control over all four aspects as at the end of the day the client is the customer and they ultimately decide what service they require and how they would like it performed. However, if one or more of these aspects is missing, the issue of control is unlikely to be a conclusive factor.

What work is done

If the client has control over what work is to be done then it is quite a strong pointer towards employment.

For example if you go into business and provide helpdesk services it is more than likely the client will have control over what work is to be done as you are simply responding to whatever work needs to be completed at a particular time. If the client tells you to look at the server or fix a workstation on a particular day, you do it. The client is also likely to have control over what work is to be completed where you form part of a coordinated team, responding to issues as and when they arise.

To maintain control over what work is to be completed it is a good idea to define specific deliverables which once completed can be signed off by the client. This way you are not responding to work as and when but delivering a service defined by specific project milestones.

With support services, even though a contractor may be responding to client requests, there is a big difference if e.g. the request comes from eg a client employee who is user of an IT system turning to the

contractor as an expert to help them, rather than from a client employee who is a manager and is directing the contractor as a subordinate.

Where work is done

If you are genuinely self employed there is a good chance that at least some project work can be done remotely. If this is the case it is a good idea to ensure that the terms and conditions reflect this fact. This helps to show that you are not obliged just to turn up at the client's offices each day to work on what is assigned.

When work is done

A self employed person is more likely to have freedom over when work is to be completed. It is therefore a good idea to ensure the terms of the contract allow for flexible work patterns.

How work is done

Control over how work is done may be a strong pointer towards employment.

Mutuality of Obligation

Mutuality of Obligation means that the employer and employee have a mutual obligation to one another.

For example, if an employer recruited a member of staff on a permanent basis they would have an ongoing responsibility to provide work to the staff member each week. The staff member would have a responsibility to accept the work being offered as they have agreed to become a permanent member of staff. The terms of this agreement are defined in the employment contract between the employer and employee.

Contractors and Mutuality of Obligation

Contractors do not normally have mutuality of obligation as contracts are agreed for a fixed period of time and once complete the contractor does not have an obligation to accept any other work offered by the client. However, consideration should be given to situations where multiple contracts are undertaken at the same time.

If contract terms and conditions do not allow a contractor to undertake a secondary assignment during a project this may be an indicator towards employment. If contract terms and conditions allow work to be undertaken elsewhere at the same time then this may be seen as an indicator towards self employment.

One of the reasons contractors are so highly paid is so that the client has the ability to dispense with services as and when required.

Right of Substitution

One of the fundamental requirements of employment is an obligation on behalf of the employee to provide a personal service. If as a contractor you have the contractual right to send a suitable substitute to the client in your absence then you are not obligated to provide a personal service. This therefore may be seen as a fairly strong indicator towards self employment.

It is very important to ensure that there is a suitable right of substitution clause in any contract agreed as it is one of the key points the HM Revenue and Customs would assess in any IR35 Investigation.

To discuss IR35, Umbrella Companies, Limited Companies or anything else associated to contracting in the UK call an experienced Commonwealth Contractors Account Manager now on **0800 294 4388**.

Contract Terms and Conditions

It is very important to have a realistic and genuine Right of Substitution clause in any contract terms and conditions and for it to be in context with any other clauses.

Firstly, it is important to actually be able to provide a substitute if ever required. You should identify a number of fellow contractors with similar skill sets who could be provided if the need arose. If the service being delivered is so niche that only you as sole contractor are suitable to deliver the service there is no point having a substitution clause in the contract as there is no possibility of it actually ever being used. The clause could be seen as artificial if inserted when not required.

The substitution clause should also not be too restrictive. It could once again be seen as artificial if it were to be written so restrictively that it could never realistically be used.

The Right of Substitution and Control

Care should be taken when wording the Right of Substitution clause to ensure that it does not negatively affect other things such as the right of control. If the client has too much control over the substitution process it may be claimed that the client is looking to recruit another employee.

The power to decide upon the worker to be provided should be held with the contractor rather than the client.

Other Contract Factors

Aside from the main factors (Right of Control, Substitution and Mutuality of Obligation) there are a number of other contract factors that should be addressed before an agreement is signed. When assessing a contract the HM Revenue and Customs (and any subsequent court) would look at the indicators that point towards self employment and those that point towards employment. They would then stand back and look at the situation as a whole. It is therefore important to satisfy as many of the self employment tests as possible if you hope to be considered outside IR35.

Financial Risk

An employed person will not normally have any financial risk when undertaking an assignment. A self employed person however may put themselves at financial risk if:

- A fixed price is quoted for a job and the job overruns
- Unsatisfactory work is rectified at no additional cost
- Materials are purchased or overheads paid in order to undertake an assignment
- Skills training costs are covered for a particular engagement

The risk of making a financial loss is a strong pointer towards self employment.

Opportunity to Profit

A self employed contractor will have the opportunity to profit.

For example, if a fixed price is arranged for a particular project and it is suitably completed 2 weeks early the contractor will profit from early completion as they can take on other assignments in that time. Also, a self employed contractor may profit where they are able to reduce overheads by sourcing cheaper materials or equipment.

An employed person would not be able to profit in this way as they would be paid a fixed salary.

Provision of Equipment

An employed person would generally have all equipment required to undertake a job provided for them by the employer. This would normally include computers, stationary, training manuals etc

A self employed contractor would be expected to provide all of the equipment required to undertake a specific contract. If the contract implied that the equipment was provided by the client the HM Revenue and Customs would argue that the contractor was employed rather than self employed.

Part and Parcel of the Organisation

Being part and parcel of the organisation (client) is normally assessed by looking at day to day working arrangements rather than the contract. However if a contract does include any information that would imply that you will become a part of the organisation, it should be removed immediately.

When you work as a contractor it is important to distance yourself from the client and ensure that you are not considered or seen as an employee. For example you should not:

- Have client business cards, you should have your own

- Be listed in the clients internal telephone directory
- Be entitled to use the staff canteen or be invited to the Christmas party
- Be part of the management team
- Appear on organisational structure diagrams

Often contractors are not seen as part of an organisation immediately but are instead slowly integrated into it.

It is strongly recommended that any assignments are limited to a maximum term of 24 months. Not only will this reduce the likelihood of integration but it also means that you do not lose your ability to claim site based expenses (see Site Based Rules).

Right to Employee Benefits

If the contract entitles you to holiday pay, sick pay or any other form of employee benefit you will find it very difficult to defend yourself in the event of an IR35 Investigation. If you intend to take profit payments from a limited company do not accept a contract with any of these clauses. One of the reasons you receive a higher rate in the first place is so that the client does not have to provide employee benefits and can terminate employment at any time. Benefits may include:

- Holiday Pay
- Sick Pay
- Maternity Pay
- Pension Scheme entitlement
- Staff car parking
- Staff gym membership

Termination

An employed person would either give or receive a notice of termination. The employee would then be required to work the notice period as specified in the employment contract before leaving the company.

As a self employed contractor once the work has been completed and signed off by the client you must be able to walk away from the client without any restriction. If the client has the ability to retain your services until a notice period has been worked then this is a very strong pointer towards employment.

Notice periods given during an assignment by either party may still be considered a pointer towards employment but only a minor one at best.

Contract Term

The contract term on its own is not a pointer towards self employment. However, taking shorter assignments of 6-12 months may support an argument towards self employment as employed people normally stay with an employer for a long period of time (1-2 years plus).

Remuneration

An employed person will normally receive a fixed salary and a regular monthly payment. Self employed contractors generally submit invoices on completion of deliverables at irregular intervals. If you receive the same amount each month on the same day you could give the impression of employment rather than self employment.

2003 Employment Agencies and Employment Businesses Conduct regulations

Opting out of the 'Conduct Regulations' is another way of showing that you set out to be a professional supplier rather than someone hoping to benefit from quasi-employee protections from the Conduct Regulations

Daily IR35 Working Arrangements

Many contractors think that because they have undertaken an IR35 assessment and have agreed on paper to an outside IR35 contract that they are safe from the threat of IR35, this is not the case. The HM Revenue and Customs can look beyond the contractual terms to the underlying working arrangements. It is desirable to have proof that the working arrangements are/were in line with the contractual terms. If no proof is available HMRC may try to deem income as having been caught by IR35.

It is therefore very important to keep hold of as many documents as possible to prove that actual working arrangements back up contract terms. Documents should be held for at least 6 years after the completion of a contract as this is the length of time that the HM Revenue and Customs can go back in order to investigate.

To find out more about IR35 and contract structures such as Umbrella Companies and Limited Companies call Commonwealth Contractors now on **0800 294 4388!**

Conformation of Working Arrangements

It is often a good idea to get a letter signed by the client in advance of starting a contract that confirms actual day to day working arrangements. However, if the contract is via an agency, it is unwise to antagonise the agency by doing this 'behind their back'.

The letter should include information supporting your claim of self employment and should attempt to satisfy as many of the self employment tests as possible. Not only will this provide security in terms of having a document signed by the client that confirms self employment but it also means that if the HM Revenue and Customs were to contact the client first both accounts would match.

Satisfying the Self Employment Tests

It is important to prove that you're a self employed contractor, not a disguised employee of the Client. In order to do this you will need to satisfy and prove as many of the self employment tests as possible.

Work from Home: If contract terms and conditions allow you to work from home make sure that you actually do so now and again and get email or other conformation from the client.

Equipment: Bring your own equipment to undertake the work and get the fact signed off in a letter confirming working arrangements. To provide additional security you could send emails from the computer and keep records proving that it is was used for contract work.

Substitution: Although you may never actually invoke this clause it can be very helpful to get an email or some additional validation from the client to confirm that you can provide a substitute where required. Make a list of possible substitutes to be used in the event of actually having to invoke the clause and keep full records.

Financial Risk: Keep detailed records of expenses incurred undertaking the assignment, and of any exposure you may have had – e.g. the cost of paying a subcontractor to do some of the work

These are but a few examples of keeping records to back up your working arrangements. You should spend some time looking at your individual working arrangements before starting any new contract and making sure that suitable documentation is in place.

Dealing with Contracts Inside IR35 and Outside IR35

It is important to understand that a limited company is never 'Inside IR35' or 'Outside IR35'. IR35 applies to individual contracts not to the corporate entity as a whole. A limited company may undertake a number of contracts, some of which may be Inside IR35, some of which may be Outside IR35.

When considering going into business with a limited company you need to evaluate the proportion of contracts you believe you will take that are Inside IR35 versus the proportion that will be outside IR35. If you believe that more often than not you will be working on contracts Inside IR35 you should consider using an umbrella company solution such as Expat Advantage or Payroll Umbrella. With an umbrella company everything is done for you. There is no need to worry about VAT returns, PAYE payments, annual returns, annual accounts etc.

For more information on Umbrella Company solutions and going into business with your own Contractor Limited Company call Commonwealth Contractors now on **0800 294 4388!**

Income arising from Contracts 'Outside IR35'

Where a contract is considered to be 'Outside IR35' you can take company profits from the limited company in the form of dividends. This allows you to avoid large amounts of Tax, in particular Class 1 National Insurance payable on income that would otherwise be paid through the Pay as You Earn (PAYE) scheme.

You can also claim whatever you like in business administration expenses as you're not restricted by the 5% expense rule (which applies to those Inside IR35).

Income arising from contracts 'Inside IR35'

If a contract is Inside IR35 all earnings related to the contract are deemed to be salary by the HM Revenue and Customs. Your limited company must operate a PAYE scheme and deduct Income Tax and Class 1 National Insurance from all salary payments.

On top of this you're also restricted when it comes to claiming business administration expenses. The HM Revenue and Customs allows 5% of contract income received to be taken in the form of business administration expenses where Inside IR35. This only applies to business administration expenses not site based expenses such as travel and subsistence.

Keeping records of Contract Status

You're advised to keep detailed records of all contracts taken so that you can identify IR35 contract income when making an end of year calculation. You should record which contracts were Inside IR35, which contracts were Outside IR35 and the business expenses claimed relating to each.

At the end of the financial year an IR35 calculation should be undertaken. The IR35 calculation will allow you to see the final figures for 'deemed salary' and profit relating to Inside and Outside IR35 contract work. Once final profit figures have been established a final dividend can be paid (where not wishing to retain company profits).

When to consider IR35

IR35 status depends upon terms of the contract the company is engaged on and the actual day to day working arrangements. Often many of the working arrangements are detailed in the contract so if you fail to consider IR35 when signing a contract you may already be caught.

The price of not checking contracts may be very high as the HM Revenue and Customs has the power to go back up to 6 years to recover liabilities where it has found a contract to actually have been Inside IR35. For many freelance contractors the prospect of paying backdated tax and interest / late payment penalties is a significant concern

IR35 Expenses

If you are genuinely considered self employed (outside IR35) and you run a limited company you may be able to claim more in the way of business expenses than if you are caught by IR35.

Limited Company Contractors

If the contract your limited company is working further to is considered to be outside IR35 you may be able to claim many types of business expense. As you are providing consultancy services and are not deemed to be a 'disguised employee' of the client it may be possible to claim company administration expenses such as the cost of your business premises, Accountancy and Tax advice, Professional Insurance cover etc. These business administration expenses are on top of business expenses incurred further to work on a client site (e.g. travel and subsistence).

However, where your limited company is working further to a contract that is Inside IR35 you will find that you are restricted by the HM Revenue and Customs on what business administration costs you can claim. The HMRC will allow you to claim 5% of contract income as an administration expense allowance where Inside IR35. This allowance covers company administration expenses such as:

- Business premises
- Accountancy and Tax Advice
- Contract finding costs
- Professional Insurance Cover
- Computer equipment
- Training costs
- Bank charges

Limited Company Contractors and the 5% Expense Allowance

The 5% expense allowance can be claimed by a contractor at the end of the financial year once an IR35 calculation has been undertaken. The IR35 calculation would look at all contract income generated by the limited company in the financial year and work out the proportion that was earned further to contracts considered Inside IR35. Receipts should still be kept with regard to any claims made against Corporation Tax.

Site Based Expenses

The IR35 legislation only affects business administration expenses incurred by the company; it does not affect site based expenses such as travel to and from the client site, overnight stay in a hotel or B&B, site based subsistence etc. Freelance contractors only need to ensure that they are complying with Site Based Rules when claiming expenses further to a temporary client site.

Umbrella Company Expenses

If you are working on a number of assignments that are considered to be Inside IR35 you should probably use an umbrella company solution to deal with contract income.

An umbrella company solution, such as Expat Advantage or Payroll Umbrella will allow you to claim a number of site dependent business expenses during the assignment. For more information on expenses allowable under Expat Advantage and Payroll Umbrella speak to an Account Manager now on 0800 294 4388 or submit your details and we will get right back to you.

IR35 Deemed Payment

If a contract you are working on is considered to be Inside IR35 you must pay full Income Tax and Class 1 National Insurance deductions (Employers and Employees) on salary payments made throughout the year. At the end of the tax year you need to make sure that any tax deductions made to the HM Revenue and Customs are correct and also calculate and further income to be drawn from the company, this is known as the 'deemed payment'.

If you are a freelance contractor considering going into business with a contractor limited company or you would like to find out more about IR35 call Commonwealth Contractors now on **0800 294 4388!**

IR35 Expenses

If a contract you are working on is caught by IR35 not only will you be unable to take contract income in the form of dividends but the amount of claimable business related expenses may be reduced.

If caught by IR35 you can claim 5% of the gross fees received by the company in the form of an expense allowance. The good news is that the HM Revenue and Customs allow you to claim this 5% allowance without the need to provide any receipts to back up a claim.

On top of this allowance you may continue to claim

- a) Valid standard site based expenses incurred further to a particular assignment. Expenses include:
 - Site Based Travel
 - Site Based Subsistence

- b) Valid non-site based essential business costs
 - Subscriptions to Trade Journals
 - Professional memberships (eg the British Computer Society, or Institute of Directors)
 - Postage and Stationary
 - Professional Insurance Cover (Including Professional Indemnity)

Calculating the IR35 Deemed Payment

To calculate an IR35 Deemed Payment you should follow the steps below:

1. Calculate the total amount of contract income received by the limited company in the tax year relating to assignments considered to be inside IR35
2. Deduct the 5% flat rate expense allowance (as detailed above)
3. Add the value of any benefits received during the tax year
4. Deduct the total value of any allowable expenses paid during the tax year (includes site based travel, site based subsistence etc)
5. Deduct the total amount of Class 1 Employers National Insurance paid by the limited company in the tax year in respect of any salaried income
6. Deduct the total value of any salaried income paid during the tax year
7. The figure that you are left with after steps 1 to 6 is known as the deemed payment. If a positive value remains you must pay further income tax and national insurance on the amount

Dealing with an IR35 Investigation

IR35 Investigations are a concern for many contractors who run or have run a Contractor Limited Company in the past (unless it was before the IR35 rules came in; 5 April 2000). The only way to completely avoid the prospect of an IR35 Investigation is to receive all contract income as employment income subject to income tax and class 1 national insurance deductions.

If you are looking to remove any possible question of IR35 issues you may be best advised to use an Umbrella Company Solution such as Expat Advantage or Payroll Umbrella to deal with contract income. To find out more about our umbrella company solutions call Commonwealth Contractors now on **0800 294 4388!**

Why can IR35 Investigations be a problem?

The HM Revenue and Customs have the power to go back 6 years to investigate your tax affairs. If you are found to have been operating incompliantly at any time in that period you could face the prospect of repaying tax plus interest and late payment penalties. Few people put aside enough cash 'for a rainy day' to cover such a 6 year bill. If you run a Contractor Limited Company you should actively consider building up reserves to cover such possibilities.

Even if an IR35 Investigation turns up nothing, the whole process can last for years and be a big hassle, and a professional distraction from running your business -, not to mention costly if you have to get professional advice or help fighting your case.

What precautions should I take?

To successfully defend yourself against IR35 you need to prove that you have been working as self employed when undertaking contracts in respect of which earnings dividends have been paid. To prove this you need to make sure that any contracts and working arrangements are outside the scope of IR35.

Make sure that an IR35 assessment is undertaken on the contract and that revisions are made where required. You need to keep copies of all contracts you work further to for at least 6 years if not more. It is also important to ensure that actual working arrangements reflect contract terms and conditions. You may want to get a letter from the client confirming working arrangements (e.g. right to substitution, freedom to work from home, use of own computer equipment etc), send emails from your own computer etc

Reducing the chance of an IR35 Investigation

A full blown IR35 investigation will normally originate from a PAYE Investigation. The HM Revenue and Customs normally undertake PAYE Investigations every few years and although nothing can be done to avoid an Investigation, actions can be taken to reduce the frequency. You should make sure that you:

- Submit PAYE documents to the HMRC on time (especially P35s and P11Ds)
- Ensure that documents are completed correctly. Blatant errors may cause the HMRC to think that everything is not quite right

What should I do if I am to receive a PAYE Investigation?

The HM Revenue and Customs will notify you of a PAYE Investigation in writing or will call to arrange a meeting. If you run your limited company from home it is recommended that you arrange the meeting at

your accountant's offices. Once the meeting has been arranged you will need to prepare all documents requested by the HMRC. Documents normally include:

- Employee PAYE records
- End of year PAYE documents for all years
- Sales Invoices
- Expense Claims
- Client/Agency Contracts

Once the PAYE Investigation has taken place you will receive a letter explaining any further action to be taken (if at all). If they have found reason to question your self employed status on certain assignments you should get professional representation and dig out all contracts and documentary evidence to back up your claim of self employment.

IR35 Umbrella Company Solutions

Using an IR35 Umbrella Company is a fantastic option for those contractors either Inside IR35 or, Outside IR35 but not prepared to take on the duties, responsibilities and additional administration associated with running a Contractor Limited Company.

All contract income received via the IR35 Umbrella Company is subject to income tax and class 1 national insurance deductions with the exception of legitimate business expenses which may be claimed tax free. As all contract income is subject to Pay as You Earn (PAYE) deductions and no form of profit payment is made at any time there is no chance of facing an IR35 Investigation in years to come.

To discuss your options and to find out about Commonwealth Contractors IR35 Umbrella Company Solutions (Expat Advantage and Payroll Umbrella) call Commonwealth Contractors now on **0800 294 4388!**

IR35 and Agency Terms and Conditions

If you are unable to make suitable IR35 revisions to agency terms and conditions it is strongly advised that you use an umbrella company solution to deal with contract income.

The contract that you work to is the most important thing in determining IR35 status as it sets out how services are to be delivered and the relationship between the parties. If you fail to consider IR35 when agreeing a contract, particularly via an agency you leave yourself open to potential IR35 repercussions in future years.

When agreeing a contract you need to consider clauses such as the right of control, substitution, mutuality of obligation, provision of equipment, employee benefits, contract term etc. You may find it very difficult to make revisions to these clauses unless you command a rate of at least £300 per day. Generally the higher the rate the more bargaining power you have with the agent as skills are more niche and harder to find in the contract market. If you possess skills found in abundance you may find it very difficult to make contract revisions as the agency will simply find another worker to undertake the contract.

Benefits of using an IR35 Umbrella Company

IR35 Umbrella Companies have four main benefits:

1. Personal Administration is vastly reduced compared to running a limited company
2. Business Expenses can be claimed to reduce tax payable on contract income
3. There is no need to worry about IR35 or the MSC legislation as all income is paid PAYE
4. It is easy to prove your income by the payslips you are issued. This can make life simpler and easier (and cheaper) when you need to validate your income as is the case when applying for a mortgage, loan, or HSMP visa.

This means that you can benefit from retaining more of your contract income (by claiming expenses) while also concentrating fully on your career. Many contractors find that the time they spend each month running their limited company can be better spent training in new skills to further their career in order to command bigger and better contract rates.