

IR35 Regulations - Are you Safe?

As a provider of services through your own limited company you could be affected by the IR35 regulations.

The main points

Although this article is not intended to be an exhaustive summary of all of the regulations, it will provide an outline of the main points and we can offer more detailed advice on your specific circumstances should you require.

- In principle the IR35 regulations need to be considered if an individual provides services (either intellectual or manual) via their own limited company to third parties (possibly but not necessarily via an agency).
- The IR35 regulations impose a requirement to pay out company income as remuneration subject to PAYE/Nl and prevent companies distributing profits tax efficiently via dividends. In other words, low salary and high dividends is not an option where the regulations apply.
- They apply where the **relationship** between the individual and the ultimate recipient the services would be an employment relationship if the company and (if appropriate) agency were ignored.
- In considering the nature of the relationship between the provider of services (you) and the end user (your client) there has to be a rounded review of all the facts and a decision is based on this overall review.

Recent Developments

There have been some recent developments that add to the original regulations so it is worthwhile giving these some detailed consideration or to have a fresh think if your company has been trading for many years:

- From 6 April 2013 these regulations have been extended to automatically include circumstances where the service provider is appointed as an officer (e.g. director) of the end user.
- There is now a box on the personal self-assessment tax return that asks the question whether the individual has received money from a personal service company and goes on to request financial details about the income. ***This will include all service companies not only those covered by the IR35 regulations.***

There could be significant disadvantages in answering "no" to this question when the answer should be "yes" as although the IR35 regulations may not apply, this could be construed as an incorrect return and therefore the fixed time period that the HM Revenue and Customs (HMRC) i.e. The Tax Man, have to open an enquiry into the return is extended significantly.

A recent Tax Case

The case involving Dragonfly Consulting Limited ultimately decided in favour of HMRC in The High Court (and therefore of some considerable authority) was, as with all IR35 cases, concerned about establishing whether the employment relationship existed in that particular case. The decision indicates that the following issues are likely to be helpful in ascertaining the position but are not decisive:-

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| • The intention of the parties. | • Training arrangements for the contractor. |
| • Provision of small items of equipment by the contractor. | • Sick pay and holiday arrangements. |
| • Attendance of the contractor at social functions. | • Payment by the contractor of minor expenses. |

The more important and therefore key issues were as follows:-

Control

This is not in connection with the detailed way in which the contractor undertakes his/her duties which are often highly skilled operations not readily susceptible to detailed control. What needs to be considered, according to the Dragonfly decision, is whether the ultimate end user of the contractor's services can determine in general terms the work to be done, the project to be worked upon and the order in which work is to be done. If such control can be exercised then there is likely to be an employment relationship existing and the IR35 regulations, would consequently apply. If the contractor is left to work independently more or less as he/she sees fit then there is likely to be a self employment relationship and the IR35 regulations would not apply.

Substitution

The key question is whether the contractor has to provide his/her services personally or whether he/she is entitled to send a substitute of his/her choosing to undertake the services in question. **If the ability to send a substitute is genuine and indeed ideally if a substitute has been used, then it is almost impossible for an employment relationship to exist and consequently very difficult for HMRC to impose the IR35 regulations.**

Obligations

- (i) If there is a general expectation that ignoring holidays, non work days and sickness, etc the contractor will turn up to provide his/her services and;
- (ii) The contractor having turned up will be paid whether or not any actual work is available or indeed in the short term whether the contractor undertakes any work at all, then there is likely to be an employment relationship and the IR 35 regulations will apply.

Other issues to consider

Of lesser importance but still worthy of consideration is HMRC guidance which indicates that, for any relationship to be regarded as one of self employment, it would be expected that a “yes” answer would be given to the following questions:-

- Do you risk your own money?
- Do you provide the main items of equipment (not the tools that many employees provide themselves) needed to do the job?
- Do you regularly work for a number of different people and require a business set up to do so?
- Do you have to correct unsatisfactory work in your own time and at your own expense?

Other relevant factors which should be considered in conjunction with the key factors of control, substitution and obligations plus the HMRC guidance as detailed above are often as follows:-

- Payment arrangements, i.e. by project (indicating self employment) or hourly rate (indicating employment) although the 2012 Tribunal decision in Primary Path Limited stated that, for **professional services**, hourly pay was to be more or less expected for both employed and self employed individuals).
- Ability to increase profitability as a result of the contractor's efforts (other than by simply working longer hours) which, if present, would indicate self employment.
- As well as the option to hire someone else to undertake the work (ie substitution), the ability to engage others to assist at the contractors own expense which, if present, would indicate self employment.
- Whether matters such as **where** services are provided, **when** services are provided and **how** services are provided are in the hands of the contractor (indicating self employment) or the engager (indicating employment). Also whether the type of service provided is commonly undertaken by a self employed individual (most likely to be professional services) or by an employed individual (most likely to be the case in respect of shop floor workers or those in administration).
- Contracts with more than one organisation at the same time (indicating self employment) or just one contract at any one time (indicating employment). However, please note. If there are a small number of contracts (say 2 or 3), it would be possible to have an employment relationship with each one, in the same way that an individual can have more than one part time employment. As the number of simultaneous contracts increases, this employment relationship is going to be unlikely.
- The contractor providing his/her services broadly by reference to standard hours (indicating employment) or at times to suit the contractor (indicating self employment).
- The undertaking of services at premises other than those of the end user or the home of the service provider and/or the holding of a professional indemnity insurance policy both or either of which, if present, would indicate self-employment.

You will appreciate that each case must be considered on its own merits bearing in mind all the relevant circumstances and some cases will certainly be very borderline. Each case must also be considered in the context of the actual circumstances rather than the theoretical terms which may be recorded in any written contracts. In other words it is important **what** you do rather than what your contract says you **should** do.

Implications of not applying the regulations

There is always the risk that the HMRC may take an interest in your business. Recently, their approach is to move towards looking at all aspects in one go. So, if an issue regarding say Corporation Tax is picked up, then interest is likely to extend to other areas, including IR35.

If this should happen and they challenge your decision not to apply the IR35 regulations the company may face considerable back taxes, penalties and interest.

In some circumstances, the HMRC could decide to try to have the unpaid taxes paid by the director personally.

With any government under pressure to increase its income without the political “death wish” of increasing tax rates, a hard line approach can be expected in the future.

What you should do:

You can choose to do your own detailed review or ask us to do one for you.

If you do your own review a suggested approach would be as follows:

- Complete HMRC questionnaire – provided on a no names basis. This can be found at: www.hmrc.gov.uk/calcs/esi.htm
- Review HMRC detailed guidance found at www.hmrc.gov.uk/ir35/guidance.pdf

Our review consists of the following:

- Initial questionnaire
- Follow up telephone conversation
- Brief report highlighting main considerations and a review of the possible risk of the regulations applying

The costs of our review:

There is a one off fixed cost of £150 + vat