ir35 and its effect on Small Businesses

In the budget of 1999 the Chancellor of the Exchequor introduced a new policy of taxation which was targeted at the small business owner.

There are a vast number of small business owners who sub-contract their skills and expertise to other companies. These small businesses are real businesses operating just like a major corporate, the difference being that instead of a potentially large workforce involving multiple departments and with a structured management team the small company often has just one or two employees.

The Chancellor decided in the 1999 budget that these small businesses weren't real in the true sense of the word, and for taxation purposes the owner of these companies ought to be treated as a deemed employee of the clients that they worked for. Which is all very well, but under IR35 (where it might apply) the deemed employee gets to pay not only his/her employEE contribution for National Insurance but has to pay the employERs National Insurance contribution as well! Plus the disguised employee doesn't get to share regular employee rewards such as pension, holiday, sickness and other benefits that a salaried employee can take for granted. When the deemed employee is out of work for any reason he/she doesn't get paid. IR35 is supposed to be about fairness, but the actual implementation is very heavily weighted in favour of the disguised employee paying more tax than an equivalent employee would.

How Does IR35 Affect You?

If you already have your own limited company where you sub-contract to other companies, and you take only salary from your employer (your limited company) then the chances are that IR35 wouldn't apply to you anyway. The legislation was intended to capture people who take a very small salary from their limited company and top it up with dividends which could be 10x or more of their salary! As National Insurance contributions are not due on dividend payments (regular tax is the same whether it is dividend or salary) the small business operator could potentially save significant amounts of money in National Insurance payments. This arrangement is entirely legal - the vast majority of big company owners and directors get paid in this way, but IR35 isn't targeted at those people.

On the positive side, many contractors have taken their IR35 case to the tax commissioners for review, and despite HMRC claiming that the individual was subject to the punitive IR35 regime the commissioners have disagreed, and come out in the individuals favour. **This article** on **The Register** web site details that in the 10 years that IR35 has been operational HMRC have managed to claw back just **£9.2m** for the treasury in their deemed employee approach to contracting. And considering that this remarkable legislation was introduced with a fanfare by the Chancellor as expected to raise some **£200m PER YEAR** then it has proved to be yet another a catastrophic failure for government.

Relevant engagements

The basis upon which your susceptibility to IR35 is measured comes down to the actual assignment which you have undertaken. There is no "magic bullet" which will protect you from IR35. Some people will fail the legislation (which is how the £9.2m referenced above has been gained).

What you need to do is make sure you understand IR35 and take steps to prevent HMRC from trapping you by the legislation. For this you will almost certainly require specialist advice. Here are some of the pointers which could help you decide:

1. Is there **Mutuality of Obligation** in your contract? In other words, regardless of whether there is any work to do, if you turn up then you expect the client to find something for you to do AND get paid for doing that work. For IR35 purposes the best option is that if the work runs out/dries up then you leave site and don't get paid.
2. Are you in business in your own account? This comes down to whether you do any other work outside of that which your client pays you for, and whether you have more than one client. If your client dropped you then would your business continue to flourish?
3. Is your contract for a lengthy period (say more than 1 year)? This isn't an actual test as such, but if you go to work for the same client at the same place day after day and month after month you could potentially start to look like an employee of that client (and you can bet that's the decision that HMRC will go for).
4. Can you substitute someone else if you can't make it into work? Employees can't do that, but if your relationship with your client accepts that someone else could turn up unannounced to carry on the job you started then it is very doubtful that HMRC could paint a picture of you being a deemed employee.
5. Do you take risks? If the project you are working on over-runs, will your client continue to pay you against time worked? If so, that's employee-like, whereas if your contract is fixed-price to deliver a specific deliverable then that might be good for your IR35 defence - employees don't get paid according to specific deliverables being made (bonuses and similar don't count - they still get a salary for turning up to work).

Remember, there are no "magic bullets" to keep you clear of IR35, but there are danger areas which you should always take into consideration when accepting a new engagement. Whilst we aren't in the business of providing legal advice we do know the IR35 legislation and can give sound advice on how best to arrange your financial affairs to protect against IR35.