

Supplying services through a limited company or partnership – A general guide to IR35

The circumstances in which the legislation applies

If you provide your services to a client (the end-user) via an intermediary, typically a service company or partnership, and the intermediary does not meet the definition of a Managed Service Company, then the IR35 legislation may apply to engagements with that client.

Broadly, it applies to those engagements where –

- you personally perform services for another person (the client);
- the services are provided not directly with the client but under arrangements involving an intermediary; and
- the circumstances are such that, if you had provided the services directly to the client under a contract between you and the client, you would have been regarded for income tax purposes as an employee of the client and/or, for NICs purposes, as employed in employed earner's employment by the client.

In addition you must receive or have rights entitling you to receive a payment or benefit that is not employment income.

The intermediary must also satisfy certain conditions.

It is therefore necessary under the legislation to construct a **hypothetical contract** between the worker and the client based on all the circumstances including the terms and conditions of relevant contracts and the actual substance of the arrangements between the parties. Subject to meeting the other conditions, if that hypothetical contract would be one of service then the engagement is within the legislation.

The existing employment status tests are used to decide whether the hypothetical contract between the worker and the client would be a contract of service/employment. The courts lay down the criteria used to decide who is an employee. More information on the criteria to be used can be found at [Employment Status](#).

Extended rules for NICs purposes

The IR35 NICs legislation is slightly different from the IR35 tax legislation in that it is not just those engagements involving a hypothetical contract of service that are subject to it.

Some earners are treated as employed earners for NICs purposes although for tax they may be self-employed. This means that certain engagements may be within the NICs intermediaries legislation but not the tax intermediaries legislation. Occupations that may be affected include **lecturers, teachers, instructors** or those engaged in a similar capacity in an educational establishment; **office cleaners** and cleaners in any similar capacity; and

entertainers. The same is true of those holding **non-executive directorships** via a service company.

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Do the rules apply to me?

The rules will apply to your intermediary does not meet the definition of a Managed Service Company, and you can answer ‘yes’ to both the following questions.

- Would you be an employee if you worked for your client directly and not through your company or partnership?
- Does the company or partnership you work through meet the conditions set out below?

These questions are explained in more detail below.

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Would I have been an employee of my client?

The IR35 rules only apply if you would have been an employee of your client, had it not been for the existence of your Personal Service Company or partnership.

If you can answer ‘yes’ to most of the following questions, you would probably have been an employee of your client for the contract in question and therefore within the new rules.

- Do you work set hours, or a given number of hours a week or a month?
- Do you have to do the work yourself rather than hire someone else to do the work for you?
- Can someone tell you at any time what to do, when to work or how to do the work?
- Are you paid by the hour, week or month?

- Can you get overtime pay?
- Do you work at the premises of the person you work for, or at a place or places he or she decides?
- Do you generally work for one client at a time, rather than having a number of contracts?

If you can answer ‘yes’ to most of the following questions, you would probably **not** have been an employee of your client and therefore outside the new rules.

- Do you have the final say in how you do the work for the client?
- Can you make a loss on the contract?
- Do you have to provide the main items of equipment you need to do the job for the client, not just the small tools many employees provide for themselves?
- Are you free to hire other people on your own terms to do the work you have taken on?
- If you are free to hire other people on your own terms, do you pay them out of your own pocket?
- Do you have to correct unsatisfactory work in your own time and at your own expense?
- Do you have a number of clients at the same time?

You will have to think about each contract individually. Some people will find that they have some contracts, which would have been employment and so come within the rules, and others which do not.

The number of clients you have **may** be relevant to the decision whether your work for each as an employee, or as a self-employed person. If you have many different clients this **may** indicate self-employment, and be a factor that should be considered in addition to the actual details of each contract. If you have a number of different clients, but are unsure whether you are within or outside the rules, you may wish to talk to your HM Revenue & Customs Enquiry Centre.

More information about employment status can be found at [Employment-Status](#)

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Does the company or partnership I work through meet the IR35 qualifying conditions?

If your services are supplied through a company, and the company does not meet the definition of a Managed Service Company, the IR35 rules apply if:

- you (or your family*) control more than 5 per cent of the ordinary share capital of the company, or
- you (or your family*) are entitled to receive more than 5 per cent of any dividends from the company, or
- you receive, or could receive, payments or benefits from the company which are not salary, but could reasonably be taken to represent payment for the services you provide to clients.

If your services are supplied through a partnership of which you are a partner, and the partnership does not meet the definition of a Managed Service Company, The IR35 rules apply if:

- you (or your 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 you receive an amount based on the payments received for your services to clients.

(* family includes an unmarried partner)

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What happens if the IR35 rules apply to my contract?

Your Personal Service Company/ partnership should operate Pay As You Earn (PAYE) and pay NICs on any payments of salary during the year in the usual way.

You may also have to pay an additional amount of tax and NICs, based on the payments received by your PSC or partnership for your services, at the end of the tax year or earlier, if you break your connection with the company or partnership during the year (see '[Common questions](#)'). Your PSC or partnership will also pay employer's NICs on the same amount.

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What should I do at the end of the tax year?

At the end of the tax year you will need to check that you have paid the correct amount of tax and NICs. If not, you may have to pay additional tax and NICs.

To calculate if any tax or NICs are due at the end of the year, see the notes 'How to calculate the IR35 deemed payment'.

Common questions

Does the IR35 deemed payment have to be paid as salary on 5 April?

No. The deemed payment is simply a means to calculate the tax and NICs due, whether or not any payment is actually made to the worker. It can be paid as salary, but the rules do not require this to happen. It may be given to the worker (or others) in the form of dividends, or may be retained in the Personal Service Company.

Where the PSC is treated as making a deemed payment and pays a dividend, it may make a claim for relief. If HMRC is satisfied that relief should be given in order to avoid a double charge to tax, relief is given setting the amount of the deemed payment against the dividend so as to reduce the dividend.

The deemed payment and employer's NICs due on it can be deducted when calculating your PSC's corporation tax.

PSCs should be aware an extra payment of tax and NICs might be due at the end of the tax year and budget accordingly.

When must I pay any additional tax and NICs?

Any tax and NICs due at the end of the tax year as a result of the calculation of the IR35 deemed payment should be paid according to the normal PAYE and NIC payment rules. The amount of the deemed payment and the tax and NICs due on it should, if possible, be included in the PAYE return by 19 April and in the Employer's Annual Return (Form P35), which has to be sent to HMRC by 19 May.

Most of the information needed to calculate the final tax and NICs liability should be available before 5 April and it should be possible to make an estimate of the tax and NICs due at that point. It will be important to keep records of relevant income and expenditure so that you can do this.

However, if it is not possible to calculate the correct amount by 19 April, HMRC will accept a payment of a lower amount on account of the tax and NICs due, as long as it is made clear on the Employer's Annual Return (P35) that the amount is provisional.

There will be an interest charge on any of the tax or NICs due on the deemed payment, if it is paid after 19 April. But, if you make it clear on the P35 that the amount is provisional, no penalties will be charged if you pay the correct amount by the following 31 January.

This concession on penalties will be reviewed annually to establish whether it should continue to apply for future years.

If you do not send the final amount by 31 January following the end of the tax year, HMRC will take steps to collect any unpaid tax or NICs, and any interest due. In addition penalties may be sought in cases of negligent or fraudulent conduct.

What if I stop working through my Personal Service Company or partnership before the end of the year?

If you stop working through your PSC or partnership before the end of the year, the deemed payment should be calculated in the normal way, and will be treated as having been made immediately before you stop. Please contact your HM Revenue & Custom Enquiry Centre or IR35 helpline (Tel No: 0845 303 3535) for further advice.

What expenses can I deduct in calculating the IR35 deemed payment?

In addition to the flat rate deduction of 5 per cent, the following expenses can be deducted in the calculation.

- Any expenses met by your company or partnership that an employee of the client would have been able to claim against income tax if he or she had spent the money personally (such as certain travel expenses, professional subscriptions and premiums for professional indemnity insurance). Booklet [Expenses and benefits - A tax guide](#) provides full details. More details about travelling expenses are given in the next section.
- Any pension contributions paid by the company to an approved pension scheme for **your** benefit (but not for anyone else).

What travelling expenses are allowed in calculating the IR35 deemed payment?

This will depend on your pattern of working. If you work through your Personal Service Company or partnership for a series of clients in different places, you may be able to deduct the costs of travelling to your clients' places of business. Provided you do not expect to spend more than 40 per cent of your working time at any one site you are entitled to a deduction for all journeys from home to the clients' premises.

If you do spend more than 40 per cent of your time at a single site, but the engagement is both expected to, and actually does, last for no more than 2 years, a deduction for travel costs will also be available. Further details are in Booklet 490 [Employee Travel – a tax and NICs guide for employers](#).

What about company cars?

For years 2002-03 onwards, where

- the intermediary provides a vehicle for you and
- you would have been entitled to an amount of mileage allowance relief for a tax year in respect of the use of the vehicle if you had been employed by the client and the vehicle had not been a company vehicle, a deduction is given at Step Three for that amount.

If the Personal Service Company or partnership provides you with a car for your private use, you will have to pay tax on this benefit according to the rules that apply to other employees. The amount of the car benefit charge can be deducted (at Step 5) in calculating the deemed

payment. See sections 11 and 12 of booklet 480 [Expenses and benefits - A tax guide](#) for further details.

Class 1A NICs paid on the company car benefit will be deductible in the calculation of the IR35 deemed payment, alongside other employer's NICs.

Your PSC or partnership will be able to set any costs of providing the car, including capital allowances, against its taxable profits.

What do I need to put on my Self Assessment return?

The IR35 deemed payment is treated as income from employment with the Personal Service Company or partnership. It should be recorded on your Self Assessment return on the supplementary employment pages. If you have any other income from employment with the same PSC or partnership you should record the total amount, including the deemed payment.

How do I apportion expenses between engagements that are affected by the new rules and those which are not?

In calculating the IR35 deemed payment, you can deduct expenses paid by the Personal Service Company or partnership which you would have been allowed to claim against tax if you had been an employee of the client, and spent the money yourself. These expenses must relate specifically to your engagement with that client. You will have to keep suitable records to be able to identify the correct amounts.

For example, this could be by reference to car mileage to work out what part of the motoring expenses related to engagements affected by the new rules.

If a client makes a single payment in respect of two or more workers, how will the income be split between them?

This will depend on the particular facts and circumstances. If a Personal Service Company or partnership receives a payment in respect of services provided by more than one worker, the payment should be apportioned between them, by the PSC or partnership, on a reasonable basis. HMRC will re-apportion any payment if it appears the company's or partnership's basis of apportionment is unreasonable. The company can appeal against the decision of HMRC.

What are my tax and NICs liabilities if I work overseas?

If you work overseas your tax and NICs liabilities are the same as if you were employed directly by the overseas client. Further information on liability and the rules about residency can be found in the HMRC booklet IR20 [Residents and non-residents - Liability to tax in the United Kingdom](#) (PDF 423K).

Can I avoid the legislation by using an offshore Personal Service Company?

No. If you would have been liable to UK tax and NICs had you been employed directly by the client, you must pay UK tax and NICs under these rules, whether or not your service company is located in the UK.

If an offshore company fails to deduct and account for PAYE tax and NICs under the IR35 legislation, liability to pay tax and NICs can be transferred to you. Action to recover employer's NICs not paid by an offshore company could also include action against any assets of that company located in the UK.

HMRC has powers to obtain details of payments to offshore companies from the records of clients and agencies.

Where can I get advice about whether the IR35 legislation applies to my contracts?

Advice can be given on existing contracts only.

The company or partnership is required to submit a form P35 by 19 May following the end of the tax year. Consequently, HMRC will not usually give opinions to companies/partnerships on contracts relating to a particular tax year unless all information sufficient to form an opinion is supplied prior to that date.

HMRC will review the facts. This will involve looking at whether the relationship between a worker and a client would have been one of employment, if there had been no company or partnership. In order to do this, HMRC will review the contract or contracts, which establish the relationship. They may also want to talk to you and to others, including the client. It is up to you to provide all the information. If you do not or cannot do so, it may not be possible for HMRC to form an opinion.

Commissioner's Tips

The Lime-IT verdict gave pointers from the Special Commissioner as to what contractors must do to make their contracts outside IR35. He ruled that a number of contractual factors contributed positively to his decision to rule that Lisa Fernley was not a disguised employee of Marconi, but that her company Lime-It was a small business.

- 1.** Firstly, it is crucial that when the contract is for a fixed period of time, which they usually are, then it should be stated that this is just an estimate for the work to be done.
- 2.** The work to be done should be stated explicitly in the contract, and if you can, make it as unique as possible to your own skill set.
- 3.** Make it clear, in the contract, that you will be doing only the tasks stated in the contract.
- 4.** State in the contract that the hours worked per week may vary based on the work needed to complete the project.
- 5.** Make the payment terms and invoicing terms explicit in the contract, e.g. that your company must be paid X days after receipt of invoice. If you can put a penalty clause in.
- 6.** The substitution clause appears to be of the utmost importance. Make sure that you have the right of substitution, i.e. the right to replace yourself with someone else, written into the contract. The Special Commissioner said that Case Law showed that where there is a right of substitution then you **MUST** be considered to be a small business rather than an employee. The Commissioner also said that the substitution clause in your contract must be taken at face value by the courts without evidence to the contrary.
- 7.** Give your client company the right of refusal for any substitute that you offer.
- 8.** Make sure that you register for VAT and that your contract states that it will be added. This will distinguish you from an employee, as they **NEVER** charge VAT on top of their salaries.
- 9.** Have it stated on your contract, that you will be responsible for all expenses for travel between your client's different sites. This is a bit of a downer, but let's hope that it is just bus fares or tube tickets, rather than flights to Sydney. I'm sure that you can do most of what you need to do over the phone or the internet anyway.
- 10.** If it is a job where you can use your own laptop rather than the company's, at least part of the time, have it stated in your contract that you will be responsible for supplying your own PC.

Strong Indications

While it can never be said for definite how the Inland Revenue will view these changes, there have been strong indications by the Special Commissioner (see our archived article "Reasons for the Verdict: What Contractors Can Do to Stay Outside IR35") that these clauses in the contract will be points in favour of you being viewed as a small business rather than a disguised employee.

Burden of Proof

As in almost all other appeals the burden of proof in an IR35 appeal is on the appellant. That means that it is up to the appellant to show that the Inland Revenue are wrong and that the worker should not be regarded as an employee of the client.

A number of factors are relevant but none is conclusive.

Some relevant factors include:

- (1) how the payments for the work are calculated; whether this is by the volume of work done or by reference to the number of hours worked;
- (2) whether the worker gets paid for sickness and holidays and what the pension arrangements are;
- (3) whether the worker's absences have to be approved in advance;
- (4) whether the client can control what, where, when and how the work is to be done;
- (5) whether the worker must do the work personally or whether he can provide a substitute;
- (6) whether the worker provides his own tools and equipment;
- (7) whether the worker is part and parcel of the client's organisation;
- (8) whether the worker occupies a post (such as General Manager or Secretary) in the client's organisation;
- (9) whether the worker has a job title in the client's organisation;
- (10) whether the worker works continuously for the client or whether the worker has a series of engagements;
- (11) whether the worker hires his own employees;
- (12) whether the client is obliged to offer work and whether the worker is obliged to do the work;
- (13) whether the worker works, or can work, for other clients;
- (14) whether, and under what conditions, the contract can be terminated by the client;
- (15) whether the worker assumes any financial risk; and
- (16) whether the worker has an opportunity to make a profit on his own account

Point 1: Background

The background factors that could affect your IR5 status:

- What is the background for obtaining the work?
- Did the job advertisement want a self-employed contractor or an employee?
- Are you replacing an employee? When replacing an employee, it's likely you'll be expected to be an 'employee' also.

Check if you are replacing an employee or another contractor before you start.

Point 4: Mutuality of Obligation

The [mutuality of Obligation](#) is important, and any contract should include this point.

You should consider what would happen if you were offered work elsewhere. Would you be able to leave the present client and go and work elsewhere at the same time, or would the present client object?

If your contract allows you to work elsewhere at the same time then this is a pointer towards self-employment.

If the client refuses to let you work elsewhere then this points towards an employee. If there is no clause in the contract, then you should include one as a matter of urgency.

Point 5: Control

If the client has control over your working conditions, it's more likely you will be classed as an employee. Thus, the contract should not have any control.

Clauses to avoid are:

- Time you start and finish each day
- Days you are expected to work
- Times you can take your lunch.

These are pointers towards employment.

Any contractor who wants to be outside IR35 will need to ensure they can organise their work and the days they work rather than the client.

Point 6: Substitution

You should ensure there is a clause in the contract allowing you to send a substitute if you are unable or unwilling to work at any time.

This must be a realistic clause, so you should ensure you know of a number of other contractors who are skilled enough to undertake the work for you, if you are unable to work the contract yourself.

If you have no substitute arranged, the Revenue will assume you are “a disguised employee”.

Point 7: Financial Risks

If your contract allows you to be paid the same amount per month from the same client then it can give the impression that you are paid similar to an employee.

A self-employed contractor is more likely to be paid on an irregular basis on production of an invoice when certain stages of the project work are completed.

Regular monthly payments often indicate employment.

Point 10: Intentions of the Parties

It is worth making it very clear in any contract, that the agreement is one of client and contractor, not of employer and employee.