

IR35 Personal Service Companies

What is it?

HMRC have special IR35 rules which are designed to prevent the avoidance of tax and national insurance contributions through the use of personal service companies and partnerships.

Note, individuals can still operate through either their own personal companies or a partnership, but IR35 seeks to remove any possible tax advantages from doing so.

Removal of tax advantages

The tax advantages mainly arise by extracting the net taxable profits of the company by way of dividend. This avoids any national insurance contributions which would have been due if that profit had been extracted by way of salary or bonus.

The intention of the IR35 rules is to tax most of the income of the company as if it were salary of the person doing the work.

To whom does it apply?

The rules apply if; had the individual sold their services directly rather than through company or partnership they would have been classed by HMRC as employed rather than self-employed.

eg. An individual operating through a personal service company, but with only one customer for whom they work full time is likely to be caught by the rules. On the other hand an individual providing similar services to many customers is far less likely to be affected.

Planning consequences

The main points to consider if you are caught by the IR35 rules are

- The income of your company will be charged to income tax and national insurance at personal tax rates rather than company tax rates
- Consequently there may be little difference to your net income whether you operate as a company or as an individual
- If you have a choice in the matter would you want to continue to operate through a limited company
- If the client requires you to continue as a limited company can you negotiate with the client for an increase in fees to cover the extra tax and national insurance due

Employment V self-employment

One of the major issues under the rules is to establish whether particular relationships or contracts are caught by the IR35 legislation. This is because the dividing line between employment and self-employment has always been a fine one.

All of the factors will be considered, but overall it is the intention and reality of the relationship that matters.

The following factors are relevant to the decision. HMRC will consider the following to decide whether a contract is caught under the IR35 rules

- Mutuality of obligation
The customer will offer work and the worker accept it as an on-going understanding
- Control
The customer has control over tasks undertaken and hours worked
- Equipment
The customer provides all of the necessary equipment
- Substitution
The individual can do the job or send a substitute
- Financial Risk
The company bears the financial risk
- Basis of payment
The company is paid a fixed sum for a particular job
- Benefits
The individual is entitled to sick pay, holiday pay, expenses etc.
- Intention
The customer and the worker have agreed there is no intention of an employment relationship
- Personal factors
The individual works for a number of different customers and the company obtains new work in a business-like way

Exceptions to the rules

If a company has employees who have 5% or less of the shares in their employer company the rules do not apply to the income that those employees generate for the company.

Note, in establishing whether the 5% test is met any shares held by family members or associates must be included.

How the rules operate

The company operates Pay as You Earn (PAYE) and national insurance on actual payments of salary to the individual during the year in the normal way.

If at 5th April the individual salary from the salary included benefits in kind amounts to less than the company income from all of the contracts to which IR35 applies the difference net of allowable expenses is deemed to have been paid to the individual as salary on 5th April and PAYE & NIC's are due to HMRC by 19th April.

This is a potentially complex area and we will be pleased to review any contracts you may have with customers to ascertain whether they are IR35 friendly. Please note that there is no such thing as an IR35 compliant contract.

If we do not hear from you we assume that you are satisfied that your working arrangements do not make you at risk to the IR35 regulations.

Yours faithfully

ABC Accounting Services