



Legislation

A GUIDE TO IR35



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Hello from Contractor Umbrella

At Contractor Umbrella, we believe that your umbrella company should do more for you than just process your payments. We aim to make your life as a contractor as hassle free as possible, answering any queries you may have, dealing with your paperwork as well as liaising with your agency or client.

We are so confident in our level of service that we have a Commitment Charter that sets out what you can expect from us which is backed by our money back guarantee, for total peace of mind. As an employee of Contractor Umbrella you will have your own dedicated Contract Manager who is fully trained on all areas that you may have questions on and will work with you to ensure that your employment is hassle free.

The world of umbrella companies is forever changing with increasing levels of legislation and compliance surrounding the industry, that's why we take legal advice from top UK legal employment specialists Blake Morgan, and top UK tax specialists, Kingston Smith. That way, by using Contractor Umbrella, you can be confident that we keep you on the right side of the law.

As a client of Contractor Umbrella, you also have the flexibility to work via our sister company, Dolan Accountancy who are dedicated contractor accountants. This means should your IR35 status change there is no need to start looking for a limited company accountant and you will continue to receive the same high level of service and expertise that you have with Contractor Umbrella. There is no fee for this transfer and you can return to umbrella as and when your employment status changes.

We hope you find this guide useful and easy to understand, however if you do ever have any queries, please visit our website or give us a call to find out more about Contractor Umbrella and how we can help make your life as a contractor as easy as possible.

You can find out more via:

www.contractorumbrella.com

Alternatively you can speak to one of our friendly experts on **01206 591 000** or via email at:

info@contractorumbrella.com

Kind regards,

Lauren Monks

Operations Manager



What is IR35?

The IR35 legislation was introduced by HMRC in April 2000 and was intended to combat tax avoidance. It affects all contractors who do not meet HMRC's definition of 'self-employment' and applies to anyone working via an intermediary such as a company or partnership.

The IR35 status determines the way that your earnings must be processed; if you fall inside IR35 your earnings are subject to PAYE then deductions must be made for income tax and National Insurance contributions. If you are outside IR35 and you operate through your own limited company and not an intermediary, you may be able to draw dividends from the company, which do not attract National Insurance contributions.

What determines if an assignment is inside or outside IR35?

As IR35 rules have recently changed, HMRC have put together the Employment Status Service Tool (ESS Tool), which asks a number of questions to help determine your status. If you answer 'yes' to the following, then it is likely you will be deemed a 'disguised employee' and will therefore fall inside IR35.

What information do you need to complete the test?

According to the IR35 guidance notes, you will need the following details to hand before taking the test:

- the worker's responsibilities
- who decides what work needs doing
- who decides when, where and how the work's done
- how the worker will be paid
- if the engagement includes any benefits or reimbursement for expenses

You will then be asked a series of questions relating to the working practices, for example: can you provide a substitute, and if so, have you ever supplied one? etc.

Simply put, are you essentially an employee just being paid by the company rather than an independent contractor or consultant?

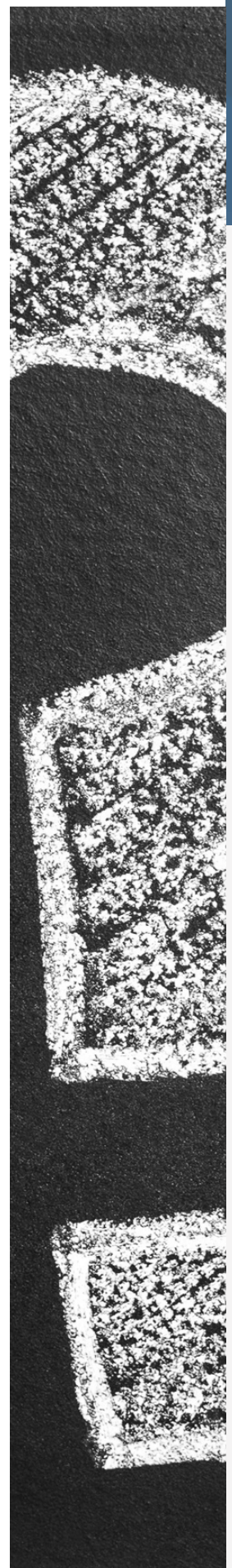
At ContractorUmbrella, we recommend having your assignment and contract professionally evaluated to determine your IR35 status. For more information please contact our sister company Dolan Accountancy on info@dolanaccountancy.com.

What does it mean if I am Inside IR35?

IR35 determines the way that you are paid. Before the introduction of the legislation contractors invariably worked through their own limited companies and drew dividends from the profits, which do not attract national insurance contributions. However, HMRC determined that, if a contract falls inside IR35, the contractor would be obliged to draw a salary from their company.

An individual employed by an intermediary i.e. an umbrella company must be paid via PAYE regardless of IR35 status. If you are employed by an umbrella company, you will be paid through PAYE and both employee and employer contributions for National Insurance will be made from the assignment rate.

For contractors who had a limited company, but no staff, this meant that they were both employer and employee and subsequently, as well as income tax, both employee's and employer's national insurance were payable.



From April 2007, after the introduction of the Managed Service Company (MSC) legislation, contractors were only able to receive dividends if they operated their own personal limited company. If they received payment through an intermediary then they could only receive payment via PAYE, which means paying income tax and national insurance contributions.

The introduction of the MSC legislation and also the Debt Transfer Legislation meant that any recruitment agency promoting the service of Managed Service Company could be held liable for any underpaid tax or national insurance contributions.

From October 2010, being inside IR35 also meant that you will be inside the scope of the Agency Workers Regulations as the same tests apply to both.

To make life a little more complicated still, April 2017 saw the introduction of the Public Sector Intermediaries Legislation which now looks for the end client / intermediary closest to the contractor to determine the IR35 status. If they deem the contractor to be caught inside IR35, then the person closest to the PSC or limited company will be responsible for deducting the employment costs and taxes before paying a net amount to the limited company, in essence the contractor is paid PAYE with no allowance for dividend payments. Since the introduction of this legislation we have seen many agencies and end clients who are simply not set up to make these deductions and will look to place all Public Sector workers via an umbrella company to ensure that no tax liability or potential fines fall with them.

An introduction to the Case Law that determines IR35

In a landmark IR35 case, HMRC presented the contractor in question with a £141,000 bill when the Commissioners decided, that in 2003 the contractor was outside IR35 but from 2004 onwards he was inside. Despite working at the same site for the same client during the entire period.

IR35 determines whether or not a contractor is entitled to draw dividends from their limited company, if a contract falls outside of IR35 you may, if inside IR35 you are deemed by HMRC to be a 'disguised employee' and therefore must be paid via PAYE. Additional tax liability, interest and penalties can be applied if a contractor who should be working inside IR35 works outside.

IR35 investigations invariably take years to complete and decisions can be appealed by either side. In the case of *JLJ Services Limited v HMRC* in 2011, the contractor had actually retired by the time the case came before the Commissioners.

An umbrella company must employ you under an over-arching contract of employment and pay you via PAYE. So, if you are working with Contractor Umbrella there is no risk to you from the IR35 legislation.

You should ensure that you have a full understanding of the IR35 legislation before deciding how you will operate as a contractor, unless operating in the Public Sector- which we will come to later in this guide. The consequences for getting it wrong can be severe.



IR35 terminology

Here are a few terms that you will need to understand when considering IR35, we have used real life examples to explain.

1. The right of substitution

A Right of Substitution means that the contract does not bind one individual to performing the services and that a replacement can be provided if required.

In the 2011 case, JLJ Services Limited v HMRC, the contractor's representative from Clearsky Accounting placed considerable reliance on the clause relating the Right of Substitution but the Tribunal judge was of the opinion that the clause had only been added to try and gain a tax advantage and that it would have 'virtually no bearing' on the approach to the decision in the case.

Their reasoning was two-fold. The clause did not make it clear whether or not the client, Allianz, could reject a substitute but it did state that they could interview a prospective replacement. The Judge considered that there would be no point in offering an interview if there was no possibility of rejection and therefore the clause was fettered. Secondly, JLJ Services Limited had no employees to be able to offer as substitutes and therefore, the Tribunal said that the clause did not reflect the reality of the situation.

In the earlier case of Dragonfly Consulting Limited v HMRC the contractor, Mr Bessell, had a contract that had a right of substitution but it was ruled that it was not an unqualified right. In his first assignment with the AA, although Mr Bessell could provide a replacement, should he be unavailable, it would have to be with 'the prior written consent' of his employment agency.

Subsequent schedules were worded differently with the final version reading 'A substitute consultant may not be deployed without having first satisfied DPP and the client that the new consultant is trained and suitable to undertake services'. This final version of the substitution clause should, one would think, give the contractor the right to provide a replacement of his choosing provided that they were fully trained. However, Mr Justice Henderson accepted the oral evidence of two employees of the AA, a Mr Kersley, who said he 'would be unhappy if a substitute turned up unannounced' and a Mr Palmer who said that he expected Mr Bessell to do the work and would not have expected him to send a substitute.

In a similar case Keith Shepherd worked, through his limited company, Alternative Book Company Limited, for Gerling NCM. There were two contracts in place, one between Mr Shepherd and the recruitment agency, Computer People and one between Computer People and Gerling.

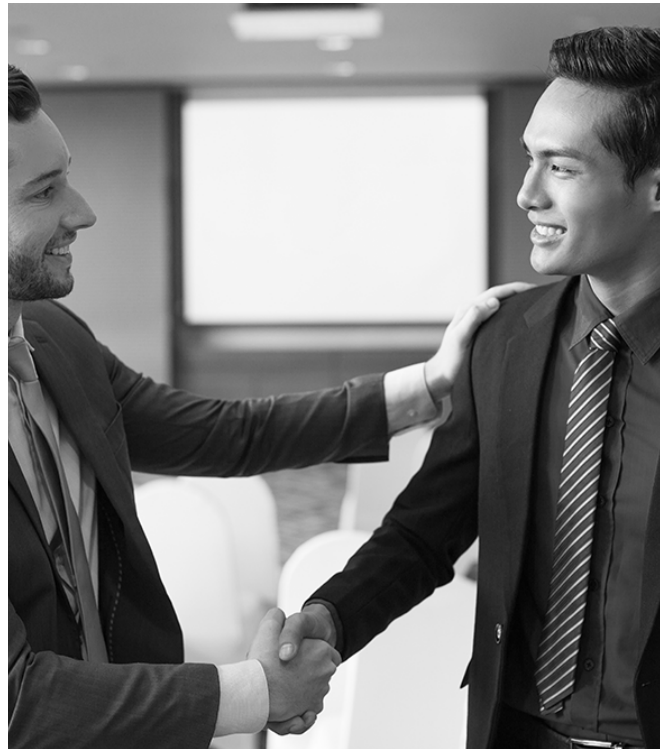
During the hearing Mr Shepherd produced a statement from Mr Gigg, of Gerling, that confirmed Mr Shepherd had a right to produce a substitute to carry out the services. However, when giving evidence Mr Gigg claimed there would be no circumstances under which he would accept a substitute. Mr Shepherd lost the case and owed HMRC two years tax and NI contributions as a result.

In the case of Island Consultants vs. HMRC the contractor had a written agreement with his client, Severn Trent Water (STW) via the agency Spring Limited, which was signed by Mr Hough of Island Consultants as well as Mr Carson of STW, that had the following clauses which all made reference to a right of substitution:

'The contractor has the right to send a substitute to carry out the services specified in the contract...'

'If the contractor has the right to subcontract the services and/or to send a substitute, the client agrees that he will accept that substitute or subcontractor if the latter has the skills to carry out the services specified in the contract.'

Two years later Mr Carson signed a statement, allegedly at the request of HMRC, which said:



'If Mr Hough were unable to fulfil personally the contractual obligations of [Mr Hough] [STW] would be prepared to consider a suitable replacement worker who was recommended and provided by [Mr Hough].

This would be subject to [STW] being satisfied that the replacement had the necessary skills and experience to complete the contract'

These examples all indicate that, if a contract is to pass IR35, the Right of Substitution must be completely unfettered. This means that the contractor must be able to provide a replacement, if for any reason he is unable to attend the contract, without prior approval from either the client or an employment agency. The client must trust that the contractor's company is operating as a business and therefore has more than one staff member capable of carrying out the required duties.

A contractor should also ensure that his contract is a true reflection of his circumstances. For instance, it is fine for an agency contract to state that a contractor is responsible for providing a replacement in their absence but if, in reality, the agency would provide a replacement this will not count as an unfettered Right of Substitution and will not help the contractor's IR35 status.

If the client agrees to the Right of Substitution the contractor must be in a position to actually be able to supply a suitable alternative worker. If it could be proved, in an IR35 case, that a contractor did not actually know anyone capable of filling his role in his absence then the Right of Substitution clause would be invalid. HMRC are becoming more stringent in their examination of contractors' working practices and therefore your contract must be a true reflection of those practices.

2. Degree of control

One of the major tests in an IR35 case is establishing the degree of control that the end user has over the working practises of the contractor.

The 2011, JLJ Services Limited v HMRC case was unique in that the contractor was deemed to be inside IR35 in 2003 but outside in 2004 despite the fact that he was working on the same site for the same client. The tribunals reasoning was that, initially the contractor was working on specific projects where, it was assumed, he and he alone had the expertise to implement the task.

Subsequently, however, the client began to divert the contractor away from projects if something urgent arose and ultimately, they offered him permanent employment, he refused but did then work under a 12 month 'rolling' contract.

In the Dragonfly Consulting Limited v HMRC case it was noted that: 'the degree of control was that which one would expect from a skilled professional employee and points towards employment'

This conclusion was arrived at for a number of reasons. The contract between the AA and DPP stated that contractors supplied by DPP: 'shall be under the full control and supervision of [the AA] on a day to day basis only regarding the performance of duties'.

Although Mr Stafford QC, representing Mr Bessell, tried to argue that this clause was intended to show a qualified (or limited) right of control, the special commissioner relied more on oral evidence supplied by employees of the AA.

Mr Bessell's work was monitored by the team manager at the AA, but it was not reviewed in detail. He was not told how to perform his tasks but was expected to complete the tasks, which had been allocated.



One of the witnesses, a Miss Tooze, testified that no-one told Mr Bessell how to do his work but, during a meeting with HMRC, she indicated that she could 'spot check' his work if she had cause. It was surmised from the witness testimony that Mr Bessell actually worked as part of a team and could not have fulfilled the terms of the contract if he did not do the work that was allocated to him.

Despite the wording of the contract between DPP and the AA, the commissioners decided that a hypothetical contract between the AA and Mr Bessell would have contained 'a provision that Mr Bessell undertake the tasks allocated to him within a specified but reviewable time frame and accept the AA's reasonable directions in relation to what he was doing'.

This was despite the fact that, during the second period of work at the AA, Mr Bessell worked from home for about 25% of the time and was therefore under no direct control from the client and despite the fact that, his representative argued, the AA appeared to exercise no more control than a householder would have over a tradesperson working at their house.

In the case of Mr Shepherd (The Alternative Book Company Limited) and Gerling NCM; Mr Shepherd was required to make frequent, informal progress reports and make a formal report once a month to the project manager. A team would carry out tests on his work and he would be expected to rectify any errors that had been made. This was according to evidence given by Mr Prentice of Gerling.

However, Mr Shepherd maintained that he had a great deal of freedom in how he carried out his work and that he worked, for the most part, on his own. Mr Shepherd did admit that he could be over-ruled by a full time member of staff but this had never happened.

During his time working at Gerling, Mr Shepherd worked on three other projects including providing ongoing support, for another company, for systems he had created earlier. However, as the work carried out away from Gerling represented less than 4% of Mr Shepherd's income, the commissioner ruled that this was 'not significant'.

In the case of Island Consultants vs. HMRC, Mr Hough worked for Severn Trent Water (STW) via the employment agency Spring. He was contracted to work four days per week although he sometimes did as many as seven days when the contract demanded it; his hours varied between five and 12 each day.

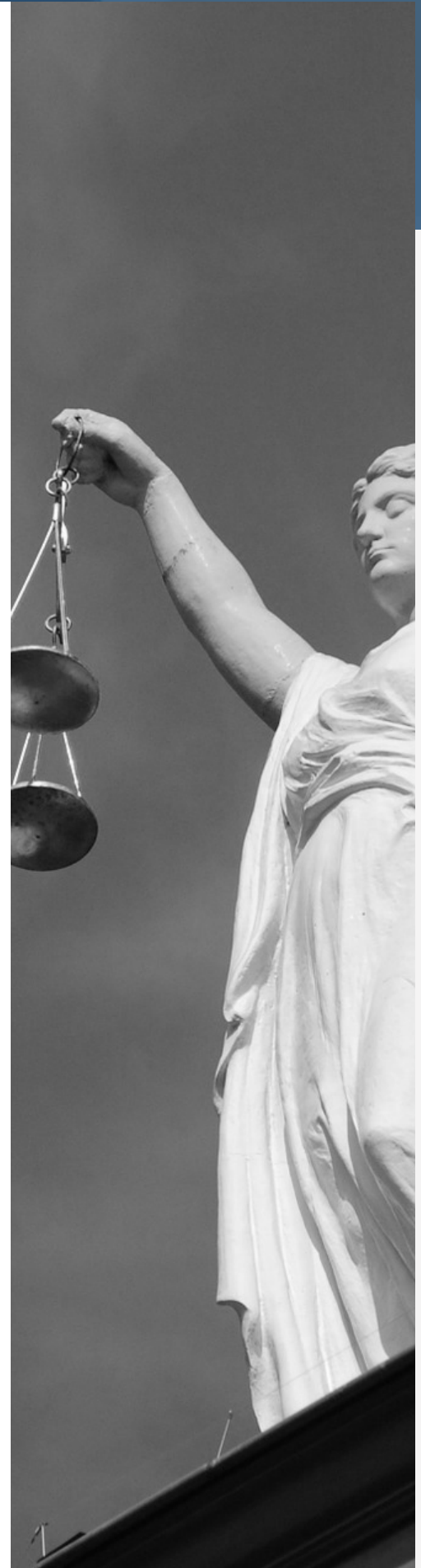
Mr Hough decided when he went to work, how long he worked for and when he had time off, absences were agreed with STW as a matter of courtesy. Mr Hough also worked from home in the evenings and at weekend, as some of his work could not be done during office hours.

Despite this freedom Mr Hough lost his case. The commissioner's comment on the question of control in this case was as follows:

'I consider that the totality of these amounted to sufficient control, though rather less than one would expect for a normal employee'.

It was considered that a professional of Mr Hough's skill and experience would be unlikely to warrant a high level of supervision.

To summarise, although control is an issue when establishing IR35 status, it is not of great significance when a contractor is at a level professionally, where high levels of control would not be expected to be exerted over someone doing the same job in a permanent position. As with the Right of Substitution, Control can also be a matter of perception, contractors should firmly establish, with the client, the autonomy that they will have and this should be fully understood and accepted by both parties.





3. Mutuality of obligation

This refers to an obligation, on the part of the client, to offer work and, on the part of the contractor, to accept work and implies a relationship of employee and employer. An IR35 friendly assignment should have no mutuality of obligation.

In the *JLJ Services Limited v HMRC* case, the Judge maintained that there is considerable case law in relation to the test which progressively indicates that it is of diminished importance or indeed nearly meaningless. This is definitely contrary to popular opinion, it had always been maintained within the industry, that absence of mutuality of obligation was a determining factor in establishing IR35 status.

The *Dragonfly Consulting Limited v HMRC* case clarified the true meaning of mutuality of obligation, Mr Bessell did not have an unfettered right of substitution and therefore had an obligation to provide services, for payment, personally. In other words, because the client would not accept someone other than Mr Bessell doing the work he was obliged to do it. Consequently, this could be taken as an indicator towards an employer-employee relationship if other factors also support that conclusion.

In the case of the *Alternative Book Company Limited*, Mr Shepherd stated that his client, Gerling, offered no guarantees to give him further work at the end of his contract and that he could not say for certain that he would accept another contract if it were offered. Unfortunately, under cross examination, Mr Shepherd admitted that he would not try to source another contract when the Gerling contract was due to expire but would wait to see if they offered more work.

Mr Hough of Island Consultants had 11 or 12 successive contracts at Severn Trent Water (STW) via the employment agency Spring. The renewals of the original contract were often arranged at the last minute and usually involved a member of STW approaching Mr Hough. Mr Hough said that he hoped the contracts would be renewed but that he had no expectation.

The commissioner decided that, although there was no obligation to renew each three or six month contract, the succession of renewals amounted to a five year project. STW was obliged to and did provide and pay for work during each separate contract period.

The situation for Martin Ellwood of MKM Computing Limited was more clear cut. Again, the contract was arranged through an employment agency but in this case the client paid when there was no work to do and would also find other work for Mr Ellwood to do if a project finished early. Mr Ellwood lost his IR35 case and ended up with a bill of £27,000.

Most IR35 cases take years to resolve and cause the contractors involved a great deal of stress and worry as, usually, large sums of money are involved. Working through an umbrella company removes the possibility that you will ever find yourself in that unfortunate position, as you are an employee of the umbrella company.

All these cases would indicate that a succession of contract renewals, which cover a long period, would not help your IR35 status. The most recent cases have also shown that mutuality of obligation will be assumed if you do not have an unfettered right of substitution.

4. Use of own equipment

It has long been accepted that if a contractor has to provide his or her own equipment for a project, this will count positively towards their IR35 status. However, this opinion was over-turned in the *Dragonfly Consultancy* case. Mr Bessell had a back problem for which he required a special chair, the chair was purchased through his company, it was not provided by his client, the AA.

Mr Bessell was also required to work from home on many occasions and he had a home office, his company had purchased two laptops, a fax and a scanner which were used for his work for the AA. According to the commissioner this pointed 'only weakly away from employment'.

In the case of Mr Shepherd and the *Alternative Book Company*, all equipment that was used on the project was supplied by the client. Sometimes the question of provision of equipment becomes irrelevant, as the situation would not arise in certain circumstances. This was the case with Mr Hough of Island Consultants who was working on his client's mainframe and also had a laptop, which the client provided.

It would seem that, in order for equipment to become a significant issue in an IR35 case it must be warranted by the contract and must be a genuine cost of business to the contractor.

Equipment will also need to be a relatively major purchase to count towards IR35 status. Bringing your own pens, calculator etc to a contract does not represent a significant purchase and will therefore be

irrelevant. Any equipment purchased must also be relevant to the contract in order to count towards IR35. If you take a laptop to work each day but it is not necessary for you to have it to fulfil the terms of the contract it will not count.

5. Having more than one client

The basis of IR35 is to determine whether or not, in a single person limited company, the contractor is truly working in business or is really a disguised employee. It has long been accepted that, if a contractor has more than one client at any one time, they are genuinely running a business and were more or less guaranteed to be outside of IR35.

However, Mr Shepherd of the Alternative Book Company worked on three other assignments whilst he was working at Gerling NCM, this included on-going support for systems that he had created at an earlier date. The commissioner in this case ruled that this was 'not significant'.

In the Dragonfly Consulting case Mr Bessell took on some work for a small, local nursery at the same time as he was working for the AA. The commissioner in the case said that the work did not provide 'a significant part of his income' and was therefore only a weak pointer away from employment.

From these two cases we can surmise that undertaking other, smaller projects whilst working on a main contract will only count, favourably, towards contractors' IR35 status if the income will represent a significant proportion of their earnings for the period.

In order to have any significance at all, two simultaneous contracts should not just represent two part time jobs i.e. contracted hours of 9 till 1 for one contract and 2 till 7 on another. Rather the contractor should be able to show that they service the clients based on their requirements.

For instance, if you needed a plumber, you would not be able to tell him that you expected him to work for you between 9 and 3 on Tuesday, you would expect him to let you know when he would be able to do the work for you, what time he would arrive and how long the work would be likely to take. This is the sort of distinction that commissioners will need to see.

6. Financial risk

HMRC argue that people who are genuinely in business for themselves have a far greater financial risk than those in employment. They also have a far greater opportunity to increase their earnings or profit. It was argued in the JLJ Services case that the contractor would suffer financial loss if the end client were to be bankrupted.

However, the judge in the case said that 'in business on own account' means taking the sort of risk that results in diminished profits from costs not being controlled or a project being undertaken on an inefficient basis because the price quoted for the project was incorrect.

In the Dragonfly Consulting case Mr Bessell, as is the case with all contractors, received no sick pay or holiday pay from his client. When there were changes in the market, Mr Bessell either negotiated higher rates or accepted lower rates.

However, the commissioner decided that Mr Bessell had no significant financial risk and these factors only point weakly away from employment.

Again, in the case of Island Consultants, HMRC argued that, as Mr Hough was on a daily rate, additional work was the equivalent of an employee being paid for overtime. HMRC's representative in the case, Mr Death, said that Mr Hough faced no possibility of his business making a loss as he had virtually no overheads.

If the financial risk, or lack of financial risk, is a deciding factor in an IR35 case



then any contractor working through an employment agency is unlikely to be successful. Although contractors do not have the benefits associated with employment such as holiday and sick pay their rates tend to be significantly higher than permanent employees and HMRC have argued that this will compensate them for their lack of job security. If a contractor is working on a daily or hourly rate and has to complete a timesheet for the employment agency, they are likely to have little risk of funds not being received. Alternatively, a contractor working on a project for a fixed rate will usually have a greater risk as he will invariably have time constraints and may have penalty clauses built into his contract.

Other important points


It is becoming more and more difficult for contractors, who work through employment agencies, to secure a contract outside of IR35. Some agencies operate a single contract, which is applied to all contractors, this is only personalised by the addition of a work schedule, which may or may not address any IR35 issues. The contract may have been written with the specific intention of placing the contractor outside of IR35, however the previous examples show that if a contract is not truly representative of the contractors' working practises it is not worth the paper it is written on.

It has also been highlighted that the intentions of the contractor, agency or client towards employment status are completely irrelevant. Therefore, a clause in a contract, which states that the contractor is not an employee of either the client or the agency, is meaningless.

Another major concern that has arisen from these cases is the unpredictability of the testimony of permanent members of staff from the client site. In the Island Consultant case the contractor, Mr Hough, obviously understood IR35 and asked his project manager to sign a document agreeing to an unfettered right of substitution. However, the project manager, Mr Carson, had a meeting with HMRC before the case was heard and signed a different statement entirely which gave Mr Hough a fettered right of substitution.

The commissioners who hear IR35 cases are beginning to add weight to whether or not the contractor has 'integrated' into the client's workforce. This means that using facilities such as a canteen or staff car park can count against you, as can your attendance at companies' social functions. Integration is obviously more likely the longer the contract goes on.

The issue of 'upper' and 'lower' contracts has also been raised in a number of IR35 contracts. This is where the contract between the agency and the contractor does not mirror the contract between the agency and the client. It may be that the contractor version allows for the right of substitution but the client version has the contractor specifically named.



Important

Should I operate outside of IR35?

Before you decide how you will operate through your limited company you should have your contract reviewed to determine your IR35 status, our sister company Dolan Accountancy will be more than happy to assist. You should also bear in mind that, although wording can be changed in your favour, if the contract does not accurately reflect the way that you are working, it will afford you no protection in the event of an HMRC investigation.

The penalties for non-compliance with the legislation can be extremely severe. Two HMRC victories cost contractors a total of almost £130,000.

Dragonfly Consulting Limited.

Jon Bessell was the director of Dragonfly Consulting Limited and was working, through an employment agency, for the AA. He lost his appeal because Special Commissioner Charles Hellier ruled that he was 'subject to the guidance of his team and team manager' which was considered to be 'a sufficient right of control' a core issue within the IR35 legislation. He commented that Mr Bessell had become 'part and parcel' of the organization:

"[The SC] is therefore of the opinion that Mr Bessell was a 'professional employee'."

Despite the fact that equipment and training were paid for by Mr Bessell's company, a strong pointer towards self-employment and despite a contract which had a right of substitution, Mr Justice Henderson who was presiding over the hearing, decided that Bessell's IR35 defense was weak.

He commented "Overall I find nothing which points strongly to the conclusion that Mr Bessell would have been in business on his own account."

The outstanding amounts from the case amounted to £99,000. To read the full details on the case please visit the Dragonfly Vs HMRC page on our website. (insert the link here please)

MKM Computing Limited.

Martin Ellwood, the sole director of MKM Computing Limited was on contract with London General Holdings Limited through an employment agency. Special Commissioner Charles Hellier ruled that: "I had the impression that while he was working at LGL, Mr Ellwood was part and parcel of the organisation. I accept that he was recognised as a contractor rather than as a permanent member of staff, but he sat alongside other members of staff, discussed future projects and was called upon for help in emergencies and worked along with them on the projects as would a permanent employee..."

Mr Ellwood had made every effort to ensure that he was working outside of the IR35 legislation. A right of substitution within the contract, meaning that he could send someone in his place if he was unwell, for instance, which is certainly something a permanent employee would not be able to do. A right of substitution is a key indicator for self-employment but the Commissioner in this case said that, despite the fact it was included in the contract between MKM and the client, the fact that Mr Ellwood would have to undertake the work himself under the terms of the contract between the client and the employment agency meant that it was not a significant factor.

IR35 cases also take into consideration the degree to which an individual has integrated into the workforce and the level of control that the company has over that individual. In this case the Commissioner admitted that Mr Ellwood "did not get instructions" on how to perform but his tasks were always allocated, his work was monitored and he worked among a team.

The fact that Mr Ellwood had to make a formal request if he wanted to take time off was also taken into account and was seen as an indicator towards employment. The outstanding amounts from the case amounted to just over £27,000.

So, what are the alternatives?

Some recruitment agencies are able to operate standard PAYE, meaning you operate as an "agency worker" and they take care of the tax side of things for you. The rate you are given in this circumstance is your taxable salary.

The alternative is to work via an umbrella company, as an employee under an over-arching contract of employment and receiving payment via PAYE. There would normally be a difference in rate between Agency PAYE and Umbrella. The uplifted rate you are given for umbrella is referred to as your contract rate and NOT your taxable salary. The uplift in rate for the umbrella option is deemed to cover the additional deductions that will be taken from the contract rate before your taxable salary is reached.

Deductions under an umbrella company

We are regularly asked by contractor's "Why am I paying the Employer's NI?"

In simple terms, all umbrella companies, as employers, have a legal obligation to pay employer's national insurance contributions to HMRC. These contributions are made from the funds received from the recruitment agency/client with whom the umbrella company will have a business to business contract, this is still deemed to be the umbrella company's funds until the taxable salary is reached.

The umbrella company's margin

This is also deducted from the contract value and is the money retained by the umbrella in order to operate the business.

The Apprenticeship Levy

The Apprenticeship Levy was introduced in 2017 to all businesses with a payroll of over £3.1m. In reality there are likely to be very few umbrella companies that will not reach this figure due to the number of workers that they have on their payroll deemed as "employees".

The Apprenticeship Levy is to be paid on all earnings subject to Class 1 secondary Employer National Insurance contributions, and equates to 0.5% of the umbrella company or Public Sector organisation payroll figure. The responsibility for the tax lies with the business closest to the PSC in the chain or the umbrella company, as the one deducting the employment taxes.

So let's put this into perspective for you, a contractor earning £500.00 per day is going to attract an apprenticeship levy bill of around £50.00 per month. For umbrella companies this means that the Apprenticeship Levy, as is Employer's National Insurance Contributions, has to be made from the contract rate.

Taxable salary

This figure is arrived at once the three figures previously explained have been paid for from the contract rate, effectively the figure left after the business costs have been accounted for.

The contractor will work with the umbrella company under an over-arching contract of employment and their salary will then be subject to income tax and employee's national insurance contributions. In a nutshell, the salary is calculated as the contract value, less the umbrella company's margin. It is worth noting that an umbrella company cannot make deductions for statutory sick pay, maternity pay and paternity pay. As your employer, the umbrella company must cover these statutory requirements from their operating profit, if this is being deducted from the rate then this may be classified as an unlawful deduction of earnings.

Holiday pay

As an employee of Contractor Umbrella Ltd you are entitled to 28 days holiday each financial year (per annum pro rata) and, under the Working Time Regulations, holiday pay must be shown as a separate entry on your payslip when you take annual leave rather than included within your pay rate. By default, we will make a holiday allowance at 12.07% of your taxable salary from your contract rate and repay this every time we make a payment to you. This means that you need to be aware that there will be no retained holiday pay available when you do take holiday.

Alternatively, if you would like us to retain a holiday allowance then you must let us know and we will arrange for a holiday pot to be set up for you. Our system will allow you to see any holiday you have accrued and reclaim it as and when you require. This can be done at the amount you wish based on the monies available in the "holiday pot". Please note if you choose this option then holiday pay is taxed at the point it is retained, and not at the point it is repaid.





Please be assured that although holiday pay is deducted it remains your money. You can enter holiday days on our system for any days you are contracted to work, but didn't. Once you have submitted a holiday timesheet, your holiday pay will be included with your next invoice payment following that period. If you have not accrued enough holiday pay to refund the total number of days entered as holiday, we will pay out as many full days as possible.

Any unused holiday pay will be refunded to you either when you leave or before the end of the financial year, whichever comes first.

The issue appears to lie in circumstances where a contractor may have been operating via their own limited company, when this may not have been the most appropriate route for their situation, worsened by potentially being advised to operate outside IR35.

HMRC had previously indicated that they had been unable to police IR35 effectively, so the changes in legislation meant that the shift in liability for determining the status would bring those inside/outside decisions back into line.

Unfortunately for some contractors, rates have not changed, and therefore the impact on the IR35 decision is now causing take home figures for some contractors to drop significantly.

Can I make my contract fall outside of IR35?

We are shocked by the number of people who operate within this industry who think that a contract can be written to be outside of IR35. The November 2011 case of JLJ Services v HMRC makes the point very, very clearly that an IR35 case will definitely fail if provisions within a contract could not be fulfilled in reality. The financial loss in this case was £140,000.

In order to work outside IR35, you need to be able to prove that you are working independently and are in business on your own account. Unless you have provable autonomy within the role i.e. the client has no real control over the duties you are performing, you are unlikely to fall outside IR35.

A contract can be written to fall outside IR35 but if it doesn't accurately reflect your working practices, it really isn't worth the paper it's written on. For example, if a substitution clause has been included in the contract, but, in reality, you don't know anyone that you could send in your place the clause in the contract would have no impact on your IR35 status.

In the JLJ Services case the Commissioners even went so far as to argue that, as the contractor had no employees, he realistically would not be able to send someone in his place if he was unable to perform his duties.

In an attempt to avoid IR35, contracts sometimes include a fettered right of substitution. The term 'fettered' means a restrictive substitution clause, used purely to force an extra pointer towards falling outside of IR35. In this situation the contract is worded in such a way that, although the individual who is contracted to work could provide a replacement, approval of the replacement would have to be given by the end client.

In the event of an HMRC investigation, inspectors would visit the client site and would interview members of staff to see whether or not you had integrated into the workforce and whether those things included within your contract would actually happen in reality. You should also be aware that these investigations can go back years, in the case of JLJ Services which was resolved in November 2011, the contracts being reviewed went back as far as 2003.

What happens if I am investigated?

HMRC generally select IR35 cases on a risk assessment basis i.e. those cases which are likely to generate the highest revenue. However, a number of cases are selected purely at random which means that anyone is under threat of investigation.

An investigation will begin as an Employer Compliance Review with no mention made of IR35. HMRC will request a meeting which you are under no obligation to attend but they do have the powers to demand to see your PAYE records. In this case you should arrange for the paperwork to be sent by post or made available at your accountant's offices.



HMRC will request to see copies of contracts that you have been working on over the past year and from there will, most typically, offer an opinion that the contract falls within IR35. Assuming that this opinion is contested, more information will be requested, more contracts looked at and working practises scrutinised. The case will be passed to a Status Inspector and could then take three or four years to resolve. Even if the case is found in your favour at the initial tribunal, HMRC do have the right of appeal which means going through the whole thing again with the Court of Appeal. At the end of the Appeals process you may win your case but you will not win back your costs, IR35 cases are extremely time consuming and extremely costly whether you win or lose.

If the process goes against you and it is ruled that you have been falsely operating outside of IR35, you would be forced to pay back all the previously underpaid tax, a penalty of similar value and interest for the time you have held onto the additional funds.

The investigation window is five years and HMRC can look into your accounts at any point within this timeframe. The moral of the story is: only operate outside IR35 if you are absolutely certain of your IR35 status.

Summary

When debating whether or not an assignment falls outside of IR35, the primary consideration should be whether or not the job remit could easily be fulfilled by a permanent member of staff, if the answer is yes then the contract is unlikely to fall outside of IR35. If you are working in the public sector, then your agency or end client will take the ESS Tool and confirm your status before you begin on the assignment, you do have the opportunity to request the test is taken again, but the final decision will fall with the agency or public sector body.

All the legal cases mentioned earlier in this guide have set precedents for future IR35 cases, the tests are becoming more stringent and the penalties, if your case fails, can be financially crippling.

If you have any further questions on IR35 or would just like to make a general enquiry, please contact a member of our team on 01206 591 000 or email us at info@contractorumbrella.com.

Which option is the best for me?

Umbrella company

If you are new to contracting, have a short-term contract, work in the public sector or intend to return to permanent employment within a year, we would suggest that you use an umbrella company for the sake of simplicity.

An umbrella company removes the burden of IR35 completely. As you will be an employee of an umbrella company and will be paid via PAYE, the IR35 rules do not apply to you. This means you can work without the worry of any additional tax bills and penalties.

Your umbrella company is responsible for sending your contributions for tax and National Insurance to HMRC and also for providing them with details of your earnings and tax paid at the end of the financial year. Your umbrella company should provide you with a payslip each time that you are paid and also a P60 at the end of the year. If you have no other source of income there will be no need for you to complete a self-assessment form.

Limited company

If you are a career contractor or your contract falls outside of IR35, we would recommend that you set up your own limited company. Your net earnings will be higher than if you worked through an umbrella company as you would be entitled to draw dividends from your company, which do not attract National Insurance contributions.

You would need to keep records of invoices raised, funds received, bills paid etc and you would also need to retain a proportion of your income to pay corporation tax as well as for your personal tax obligations. Depending on the level of your earnings you may also need to register for VAT and make provision for payments accordingly.

If you would like to discuss setting up a limited company or would like some more information, please contact our colleagues at Dolan Accountancy at www.dolanaccountancy.com or on 01442 795 100.

Umbrella or limited?

If you are still unsure which option is best, a full review of the pros and cons of each way of working can be found here:

Pro's









PAYE umbrella company	limited company
Very easy to use, you simply enter your timesheet and wait to be paid.	The most tax efficient way of working.
All tax and NI is deducted before you receive your money, so you will have no further taxes to pay.	You keep complete control of your financial affairs.
Ideal for short-term contracts, lower earning contractors or those in the public sector.	Access to the Flat Rate VAT scheme.
Perfect if you are unsure if contracting is for you and you're really just in between permanent jobs.	Running your own business isn't difficult.
Most importantly someone else will be doing all the paperwork for you.	Greater opportunity for tax planning than PAYE Umbrella.

Con's

PAYE umbrella company	limited company
Your salary will be subject to full PAYE Tax and NI.	There is a certain amount of paperwork involved.
You are reliant on the umbrella company to collect your money from the client or agent and then to pay it to you. Contractor Umbrella will chase any overdue payments on your behalf, free of charge.	Can be costly if you contract for a very short period of time and then go back to permanent employment. Neither is it ideal for low earners.

Benefits of working for Contractor Umbrella

When you work with Contractor Umbrella you can benefit from the following:

 <p>Group Personal Pension Scheme Redirect part of your income into our tax efficient pension scheme.</p>	 <p>Contractor Umbrella Rewards The scheme gives our employees access to thousands of exclusive discounts, on everyday services and products.</p>
 <p>Contractor Mortgage Getting a mortgage as a contractor doesn't have to be difficult!</p>	 <p>Give as you Earn Reduce your tax liability by donating to the charity of your choice.</p>
 <p>Foreign Currency Exchange Maximise the return on your foreign currency.</p>	 <p>Financial Services Specialist independent advice on income protection, life and critical illness cover.</p>
 <p>Private Medical Cover 30% discount on WPA private medical cover.</p>	 <p>Contract Opportunities Contractor Umbrella can help you find that all important next contract.</p>



About Contractor Umbrella

Contractor Umbrella have been helping contractors since 2002 and have been voted as the best umbrella company by readers of Contractor UK. We are one of the most respected umbrella companies in the UK and our Commitment Charter gives contractors total peace of mind.

With our sister company, Dolan Accountancy, we offer contractors a consistently high level of customer service no matter if you work via your own limited company or through an umbrella company. We give you the flexibility to transfer when your contract demands and we won't charge you any additional costs.

Key benefits of our scheme:

- Unlike other umbrella companies we do not charge a percentage of your income, our margin remains the same regardless of your earnings
- No hidden joining or leaving charges, no minimum commitment and no fees charged in-between contracts
- Contractor Umbrella Limited is an alliance partner of Contractor UK, Freelance UK, Freelancers in the UK and affiliate members of APSCo
- A commitment charter, designed to ensure all employees and clients are taken care of every step along the way
- Web-based portal giving 24/7 access for timesheet submission
- Same day payments as standard providing funds are received into our account by 9am, for no additional fee
- Personal Contract Manager for every client
- No additional fees or changing accountants if you need to work through your own limited company

For further information, you may like to visit our website at www.contractorumbrella.com. Alternatively, you can speak to one of our experts on **01206 591 000** or email us at info@contractorumbrella.com.

We look forward to hearing from you.



Contractor Umbrella

Umbrella company experts

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