



What is IR35? A guide for the self-employed

by Sam Bromley

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What is IR35, exactly, and why is it important that contractors are clued up? With new IR35 rules being introduced in April 2021, here's our guide for the self-employed.

A quick IR35 definition – and why IR35 exists

IR35 is another name for the off-payroll working rules. It's designed to assess whether a contractor is a genuine contractor rather than a 'disguised' employee, for the purposes of paying tax.

Contractors who work through their limited company enjoy a level of tax efficiency. While they don't usually get employee benefits (like holiday and sick pay), they have flexibility and control over their work.

Some contractors and their clients try to take advantage of this tax efficiency by working as if they're self-employed, when for all intents and purposes they're employees. HMRC has designed the off-payroll working rules to tackle this – but the rules aren't without their problems.

IR35's nuances mean that contractors can't be expected to know the law inside out. Please only use this article as a guide – if you're unsure about anything, seek professional advice.

IR35 helps HMRC tackle tax avoidance through off-payroll working

HMRC introduced IR35 (or the 'off-payroll working rules') in 2000 to tackle what it calls 'disguised' employment.

When a contractor is a 'disguised' employee, they might be taking advantage of the tax efficiency of working through a limited company, when they'd really be an employee were they not working through their company.

The benefit for employers is that they don't have to pay employers' National Insurance

contributions or give contractors employee benefits. The benefit for contractors is that they can pay themselves tax efficiently.

So IR35 is essentially an employment status test for tax, which works out whether a contract points towards employment or self-employment:

- if your contract is '[inside IR35](#)', it points towards employment. HMRC sees you as an employee and you face an income tax and National Insurance burden, just as employees do
- if your contract is '[outside IR35](#)', it points towards self-employment, and you can enjoy the tax efficiency that self-employment brings (as well as all the associated risks)

But IR35 rules are complicated (and controversial)

Many find the legislation complicated to understand. Even HMRC seems to struggle – its record on fighting IR35 cases at tribunal is patchy.

In 2019, TV presenters Kaye Adams and Lorraine Kelly successfully challenged HMRC in separate cases, proving that they weren't inside the rules.

A lack of clarity, along with ambiguity over employment status guidelines (including available employment rights if contractors are found inside IR35), has been controversial.



How IR35 rules work in practice

When does IR35 apply?

HMRC says that when working out whether IR35 applies to a contract or engagement, “you must work out the employment status of the person providing their services.”

HMRC goes on to say that the off-payroll rules apply if the contractor “would be an employee if there was no intermediary”. The intermediary in many cases is the contractor’s limited company (often called a [personal service company](#)).

Intermediary meaning: what is an intermediary?

IR35 is also known as the ‘intermediaries legislation’ because it applies to workers who provide their services through an intermediary, rather than working as an employee.

As mentioned, the intermediary will often be the contractor’s own limited company, or [personal service company](#).

A personal service company is a limited company where the sole director, the contractor, owns most or all of the shares. The contractor then delivers services to clients.

But [gov.uk](#) says that there can be other intermediaries:

- a partnership
- another personal service company
- an individual

A contractor can provide their services directly to clients through their intermediary, or they might work through an agency or [umbrella company](#).

What does IR35 status depend on?

IR35 status tests usually relate to **supervision**, **direction** and **control**. We go into more detail as part of our IR35 checklist below.

HMRC also has a [tool](#) called CEST (check employment status for tax) you can use to check whether IR35 applies to a contract, plus an IR35 helpline.

In reality, IR35 status hinges on IR35 case law

and employment legislation, itself reliant on decades worth of employment tests heard in UK courts.

Another problem is that CEST may not be entirely accurate, as it doesn't take a key piece of case law (mutuality of obligation, or MOO) into account.

Who works out IR35 status?

There are currently different rules for public sector and private sector contracts.

Off-payroll working rules in the public sector

- the hirer is responsible for working out whether the contractor falls inside or outside of IR35. If they fall inside, the hirer, agency or other third party who pays the contractor then needs to deduct tax and NICs and report them to HMRC

Off-payroll working rules in the private sector

- the contractor is responsible for working out whether they fall inside or outside of IR35. If they're inside, they need to pay the tax and NICs due

This is set to change from April 2021.



What are the IR35 changes?

[Private sector IR35 reform is set for April 2021](#),

when the public sector off-payroll working rules will be applied to the private sector.

This was meant to happen in April 2020, but it was delayed by a year because of coronavirus.

The upcoming IR35 changes mean that:

- medium-sized and large businesses will be responsible for working out the contractor's employment status, not the contractor
- contractors should be given the reasons behind the decision in a **Status Determination Statement**, and can dispute the decision if they disagree with it
- small businesses are exempt from the changes – if a contractor works for a small client, the contractor will still be responsible for working out their employment status

End clients are classed as small businesses if they meet two of the following criteria, for two consecutive financial years:

- annual **turnover** of no more than £10.2 million
- balance sheet total of no more than £5.1 million
- no more than 50 employees

End clients need to show they've taken reasonable care when working out IR35 status. If they haven't, HMRC will hold them responsible for getting things wrong.

Businesses and contractors should prepare for the 2021 IR35 changes. This might involve speaking to your current clients about your contracts, as well as understanding which clients count as small businesses.

The IR35 checklist below can help you get IR35 compliant.

IR35 checklist: am I compliant?

In general, IR35 won't apply if the contract is for services rather than employment. To untangle that, you should see whether the contract specifically mentions these principles:

- ✓ **supervision, direction, control** – this relates to how much say your client has over how you complete your work. For example, if you have to work at certain times, this implies employment
- ✓ **substitution** – could you bring someone else in to complete the contract, or do you need to do the work yourself? If you can't send someone else, you're likely to be within IR35
- ✓ **mutuality of obligation (MOO)** – is there an obligation on the employer's end to offer work, and do you have to accept it? This is called [mutuality of obligation](#), and if an element of it exists, the contract may fall inside IR35

The contract has to reflect your actual working practices – essentially, the clauses need to be genuine.

Supervision, direction, control

For a contract to fall outside IR35, contractors should have freedom over how they complete their work.

- ✓ a contract that specifies things like the time you can start and finish work, or the days you're required to work, points towards employment
- ✓ a contract might also point towards employment if a client oversees your work excessively and gives guidance on how to complete it
- ✓ plus, if you're not only providing your services for the agreed job but also working on different tasks as your client sees fit, the contract is likely to be inside IR35

Substitution

For a contract to fall outside IR35, you should be able to send a substitute to complete the work instead.

- ✓ does your client only want you, or services more broadly? An outside IR35 contract might state that someone else



can provide their services to complete the work

- ✓ the clause has to be genuine – you should know which skilled contractors you would ask
- ✓ plus the contract can't be so restrictive that you essentially need to do the work yourself

Mutuality of obligation (MOO)

This is an important clause in a contract, as it's a key test when working out self-employed status. If the client is obliged to offer work (and pay you) and you're obliged to take it, this demonstrates a contract of employment.

- ✓ in practice, this means a self-employed contract involves working on a project-by-project basis
- ✓ once you've completed a project, you're under no obligation to work on further tasks (and the client is under no obligation to offer them)
- ✓ you should also consider whether you can work for other clients simultaneously. If that's prohibited, it points towards employment

Other factors on your IR35 checklist

There's more criteria to consider when working out IR35 status:

- **equipment** – HMRC often tries to argue that if equipment is provided by the client, and you don't use your own, you're a disguised employee
- **financial risk** – self-employed contractors usually take a degree of financial risk, like any other business. Are you responsible for errors made during the contract, and would you need to rectify them in your own time? There's usually a requirement to have [professional indemnity insurance](#)
- **the way you're paid** – self-employed people are paid on a project basis, which might mean when the work is completed or at particular project milestones
- **'part and parcel' of the organisation**
 - if contractors become so ingrained that they become part of a company's structure, with people reporting to them for example, this points to employment rather than self-employment

- **exclusivity** – do you work for other clients? Typically the self-employed can work for multiple clients at once
- **intentions of the parties** – the contract should make sure the relationship between contractor and client is one of supplier and customer, but this should be genuine. If HMRC found the actual intended relationship is more like an employee and employer, it'll ignore the contract
- **business 'on your own account'** – essentially this determines whether you're actually running your business as a business. If you have things like a business website, a dedicated office space, and even employees, you could be seen as operating a business and not offering your services in the same way as an employee

Make sure you clarify your relationship with the hirer before you start the contract by considering all of these principles.

Again, before you start working, you should seek expert IR35 advice.



Have you thought about business insurance?

Contractors should think about a comprehensive [business insurance](#) policy, including:

- [business legal protection insurance](#) – this can cover the legal expenses for things like employment tribunals and HMRC tax investigations, including a dispute about your compliance with IR35 regulations
- [professional indemnity insurance](#) – a key cover for contractors and those who give professional services to clients. It can protect you if you make a mistake in your work that causes a financial or professional loss for your client
- [public liability insurance](#) – this can protect you if a member of the public is injured or suffers a loss because of your business and makes a claim
- [business contents insurance](#) – this can cover the equipment your business relies on every day, like PCs and laptops

Further reading

What does being inside IR35 mean? A guide for the self-employed

[Click here for more >](#)

How does HMRC define a 'personal service company'?

[Click here for more >](#)

What is an umbrella company?
A guide for self-employed contractors

[Click here for more >](#)

