STEWART ACCOUNTING SERVICES
Chartered Accountants

Personal Service Companies and IR35

The IR35 legislation is a complex set of rules, and even today, interpreting the correct course of action to take is by no means a simple task.

What is a Personal Service Company?

Prior to IR35, the use of companies had become more popular as a device to reduce tax and National Insurance contributions. This was done by paying director/shareholders a small salary and any balance of remuneration as dividends. In this way, participators could increase their take home pay, primarily by reducing liability for NIC.

It became common practice for employees providing specialist services, for example IT workers, to negotiate a contract for their services by using a company set up for this purpose. Most PSCs only had one or maybe two customers, and in effect, the work they did and the relationship with their "employer/customer" was the same. HMRC were not too happy with this arrangement and IR35 was born.

Private sector

To bring the private sector into line with obligations imposed on the public sector, since April 2021, businesses are legally obliged to determine whether National Insurance Contributions and Income Tax should be deducted from any contractors engaged by them.

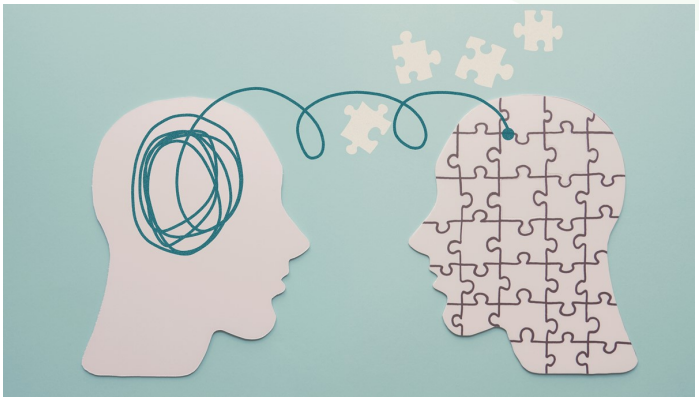
These obligations only apply to medium and large businesses in the private sector. Smaller concerns (as defined by Companies Act 2006) can continue to operate under the current rules.

What happens if you are deemed to be caught by these rules?

The broad effect of existing legislation is to charge the income of the company to NICs and Income Tax, at personal tax rates, rather than corporate tax rates. Consequently, there may be little difference to net income whether individuals operate as a company or as an employee.

Can you challenge HMRC if you feel that your relationship with a client falls outside IR35?

Indeed, you can. Your best line of attack is to demonstrate that your relationship with the client is not that of an employee and employer.



Only genuine, self-employed relationships, where you as a contractor are deemed to be providing a service to a client, and where few of the usual "flags" of employment apply, will stand a chance of making a successful challenge. The arguments for and against are subjective and you will have to work hard to win the day.

A person is generally considered to be a "worker" or employee if:

- they have a contract or other arrangement to do work or services personally for a reward (your contract doesn't have to be written)
- their reward is for money or a benefit in kind, for example the promise of a contract or future work
- they only have a limited right to send someone else to do the work (subcontract)
- they must turn up for work even if they don't want to
- their employer must have work for them to do if the contract or arrangement lasts
- they aren't doing the work as part of their own limited company in an arrangement where the 'employer' is a customer or client

How do the rules operate?

Your company would operate PAYE & NICs on actual payments of salary during the year in the normal way. If, at the end of the tax year, the individual's salary from the company, including benefits in kind, amounts to less than the company's income from all of the contracts to which the rules apply, then the difference (net of allowable expenses) is deemed to have been paid to the individual as salary on 5 April, and PAYE/NICs are due.

In this way pretty well all of the company's income will be taxed as if a salary and any tax advantage removed.

The deemed liability to additional PAYE and NIC that falls due at the tax year end, the 5 April, will be due for payment just two weeks later, the 19 April.

Does IR35 apply to business partnerships as well as companies?

Yes, it does, although the charging rules are different. Where individuals supply their services through a partnership, the rules are applied to any income arising which would have been taxed as employment income if the partnership had not existed. In other words, where a partnership receives payment under an 'employment contract', income of the partnership from all such contracts in the year are deemed to have been paid to the individuals on 5 April as salary. PAYE and NICs are due accordingly, and any amount taxed in this way is not then taxed as part of the partnership profits.

The rules only apply to partnerships where:

- an individual, (either alone or with one or more relatives), is entitled to 60% or more of the profits or
- all or most of the partnership's income comes from 'employment contracts' with a single customer or
- any of the partners' profit share is based on the amount of income from 'employment contracts'.

How can I tell if my company is a PSC?

HMRC have created an online process that provides an indication if your company is caught by the IR35 rules. It is fair to say that it has had mixed reviews. Broadly speaking, the issues that need to be considered are:

You can check employment status if you're a:

- worker providing a service
- person or organisation hiring a worker, or
- an agency that's placing a worker

To use this service, you'll need to know:

- 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

What are Managed Service (MSCs) and Umbrella Companies?

MSCs were an attempt at a structure that avoided the IR35 legislation. This escape from IR35 was cut-off by the introduction of legislation in 2007.

Umbrella companies enable contractors to operate as though they have a personal service company without them having to set it up and run it themselves. The big difference between MSCs and Umbrella companies is that the latter make all payments to the contractor through the PAYE system. There is no facility to secure tax savings by the payment of dividends.

Planning is critical

In order to avoid unexpected tax and National Insurance bills it is imperative that you take professional advice if you have any doubts about your IR35 status. In particular, we could help you:

- Deal with any contentious status disputes with HMRC;
- Advise you on whether your arrangements fail or pass IR35 tests;
- Improve your contracts with principals for the purposes of defeating IR35;
- Maintain the necessary records and information to support your position.

Managing and defending your rights under IR35 is not a process for the faint hearted or the uninformed, let us help you get the best result available based on your circumstances.

Summary action list

- Before settling on a structure for your business take professional advice to achieve the most effective tax outcome.
- Take professional advice if your present arrangements are challenged by HMRC, it is possible to appeal.
- This is a fast-changing area of taxation. Keep abreast of changes by registering for our news-feed that cover these and other tax issues.
- The legal framework for PSCs and those affected by IR35 is constantly changing, accordingly, your tax status should be reviewed each year.

In preparing and maintaining this publication, every effort has been made to ensure the content is up to date and accurate. However, law and regulations change continually and unintentional errors can occur and the information may be neither up to date nor accurate. The editor makes no representation or warranty (including liability towards third parties), express or implied, as to the accuracy, reliability or completeness of the information published in this publication.

Stewart Accounting Services Limited

01259 721 156

mark@stewartaccounting.co.uk

www.stewartaccounting.co.uk

Office 90, Alloa Business Centre, Whins Road
Alloa
Clackmannanshire
FK10 3SA