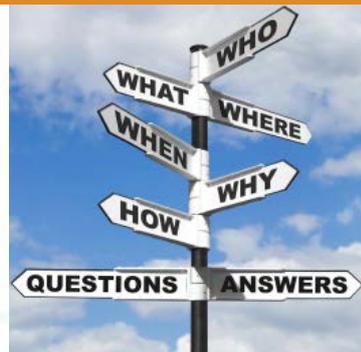


# IR35 Special

10 years that shook and shaped  
the world of UK contractors

- A look back at the lessons from the first ten years of the 'contractors tax'
- Real-life experiences of IR35 victims
- Tips and best practice on negotiating the complex IR35 landscape
- Insights from the leading UK experts on IR35 today
- A look forward to what the future holds for IR35 at this time of political and economic change in the UK.



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# Introduction

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The centrepiece of this IR35 special report is our major review of the contractor sector as seen by ten of the most influential and expert commentators in contracting today.

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As we approach ten years of IR35 becoming law, we use this special report to take a moment to reflect on what the last ten years have brought to the contracting sector. We have seen contractors demonstrating their resilience and creativity to not just survive the trials that IR35 brought, but also to rise above them and thrive.

We reflect on the origins of IR35 and the painful stages of its implementation and evolution, partly in the hope that it will be instructive to our political leaders in teaching them how not to create and implement future legislation going forward.

More importantly, we hear from you, the UK's highly skilled and creative flexible workforce of contractors, freelancers, interims and consultants. Contractors tell us how they have coped with the trials and tribulations that IR35 has brought, in a series of short interviews. And it's worth noting that not all contractors we spoke to are affected by IR35 – there is a significant constituency who have chosen to avoid IR35 by contracting through trading vehicles such as umbrella companies, even when their contracts are outside IR35.

The centrepiece of this IR35 special report is our major review of the contractor sector as seen by ten of the most influential and expert commentators in contracting today. Their unique perspectives highlight that IR35 has been a catalyst for contractors to start understanding their identity and place in the UK economy. And, as with any sleeping giant, governments should be careful of what they have awoken.

Our next two items are designed to be of practical help for day-to-day contracting, with a distillation of the hundreds of items available on [www.contractorcalculator.co.uk](http://www.contractorcalculator.co.uk) and the expert information in the *Contractors' Handbook*. There's a 10-point plan for staying outside IR35 plus an IR35 defence diary, which tells you what records to keep, why and for how long.

Everyone wants to know what the future holds, so we do a bit of fortune-telling, based on our interviews with contracting sector experts, the huge number of contractors and stakeholders (including politicians and policy makers) we engage with on a daily basis.

One of my motivations for founding ContractorCalculator.co.uk and writing the Contractors' Handbook was so that my own hard-won contracting lessons, plus those of the many other contractors and experts who contribute to the website and book, can be passed on to both newcomers to contracting and more experienced players.

That has also been one of my major drivers for publishing this special report, so that there might be a chance, however small, that those in power may read this rather damning history of IR35 and not make the same mistakes again.

I hope you enjoy reading this and find it of value. As ever, I would like to hear your views via ContractorCalculator.co.uk.

Dave Chaplin  
CEO and Editor in Chief, ContractorCalculator

# A History of IR35

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Through various organisations, the contracting sector has come together both to defend itself against the tax regime and to demand due recognition for the contribution it makes to maintaining UK PLC's position as one of the most competitive global economies.

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There is arguably no other single event which has had so much impact on the contracting sector as the introduction of IR35. It has resulted in ten years of uncertainty, pain, financial loss and even lost livelihoods for some contractors.

However, it has brought benefits, too, because over the past decade we have seen one of the most vibrant and vital sectors of the knowledge economy begin to unite and share a common sense of purpose and identity. Through various organisations, the contracting sector has come together both to defend itself against the tax regime and to demand due recognition for the contribution it makes to maintaining UK PLC's position as one of the most competitive global economies.

## So where did it all begin?

It all started one early spring day back in March 1999, with an innocuous press release buried amongst the welter of mass communiqués being carpet-bombed onto an expectant and hopeful populace as the New Labour administration was coming to the end of its post-1997 election honeymoon period.

Established contractors will be familiar with the tale of the famous, or rather infamous 'Inland Revenue 35' press release announcing that 'changes are to be introduced to counter avoidance in the area of personal service provision' to be included in the forthcoming finance bill.

The then Chancellor Gordon Brown was determined that contractors would pay their 'fair share' of tax. He specifically wanted to target those contractors who "could leave work as an employee on a Friday, only to return the following Monday to do exactly the same job as a... consultant paying substantially reduced tax and national insurance."

Actually, most contractors of the day did not have a problem with the concept of paying a fair amount of tax, particularly because they were typically higher earners and therefore already some of the highest taxpayers in the land.

## One size fits all

However, the proposed new tax laws were designed in such a way as to not only force 'disguised employees' to pay taxes, but also to include and penalise the huge number of legitimate contractors, freelancers, interims and consultants comprising the UK's world-leading knowledge economy.

And to make matters worse, the proposals from the Treasury showed that the government was not prepared to consult with those affected in any meaningful fashion. This has set the tone of much IR35-related legislation over the past 10 years, with the government, HM Treasury and HMRC making changes and moving the goalposts, with little or no meaningful consultation.

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From the outset, HMRC fought ‘dirty’, using every power in its arsenal. Even today, contractors are frequently bullied, browbeaten and intimidated into submission on the flimsiest of evidence, and find themselves accepting punitive awards of back taxes, interest and penalties.

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So, back to 1999. Following a short consultation and a spirited first battle by the newly formed Professional Contractors Group, some ‘window dressing’ amendments were made to what became law as the **Finance Act 2000 Schedule 12 Provision of services through an intermediary**. This is more typically referred to as the ‘intermediaries legislation’ or, more simply ‘IR35’.

### Progress through the Special Commissioners and the Courts

This pitched the contracting sector into what have become ongoing skirmishes with HMRC, bringing out some of the key characteristics to be found in all successful contractors – tenacity, a refusal to be beaten and creative problem-solving.

From the outset, HMRC fought ‘dirty’, using every power in its arsenal. Even today, contractors are frequently bullied, browbeaten and intimidated into submission on the flimsiest of evidence, and find themselves accepting punitive awards of back taxes, interest and penalties.

After contractors lost numerous unrecorded investigations, plus two high profile cases at the Special Commissioners and PCG’s Judicial Review, it was not until 2002 that the tide seemed to turn, with victory in the Lime IT case. Celebrations were short-lived, however, as HMRC went on to win the Synaptex, Usetech and Netherlane cases in 2003, 2004 and 2005 respectively. It wasn’t until the PCG-supported Ansell case was won later in 2005 that contractors again saw a glimmer of hope.

### Evolving IR35 case law

The past five years of the ‘noughties’ have been peppered with High Court losses and victories, varying performance in the Special Commissioners, and an increasing body of case law. This has gradually refined HMRC’s attack strategies.

The contracting sector has proved adept at adapting to HMRC’s changing strategies, but despite this, HMRC has won two thirds of high-profile cases over the past five years. And that’s not to mention the unknown numbers of contractors intimidated by HMRC into ‘accepting their fate’, even when they might have a very strong case that their contracts were outside IR35.

The real issue, which causes ongoing uncertainty, is that case law has still not identified the IR35 ‘silver bullet’ that would allow genuine contractors to remain free of the uncertainties that IR35 brings. However, case law is gradually providing a framework in which contractors and their advisers can often pre-empt an HMRC investigation before it even starts.

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The crucial thing is that contractors need to be proactive, ensuring their contracts and working practices are outside IR35, and that they have the evidence to prove it, long before a tax inspector ever opens their file.

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### IR35 – wide reaching effects

Any history of IR35 would not be complete without acknowledging the indirect impact it has had on the wider contracting sector and beyond. Indeed, an entire service industry has grown around the tax law, and new laws have been spawned to prevent IR35's circumvention.

Umbrella companies have been a key beneficiary of IR35, although they started before IR35 as trading vehicles for those contracting who didn't wish to run their own contractor limited company. Umbrella companies now attract a significant number of contractors 'caught' by IR35, as well as others whose contracts are outside IR35, but who are willing to forego the additional income they could enjoy in return for not having the perceived 'hassles' of running their own limited company.

The Managed Services Legislation (MSC) was introduced in April 2007, and is acknowledged by many contracting sector experts as a tacit admission of failure of HMRC's ability to enforce IR35. The rules required all contractors using composite company schemes to pay tax as if they were employed by their end-user clients. This resulted in mass migration into umbrella companies and contractor limited companies.

### IR35 – past, present and future

We now find ourselves in a position where a contractor who invests their time, and a small amount of money, into preparing a good IR35 defence is unlikely to find themselves falling foul of the legislation. The crucial thing is that contractors need to be proactive, ensuring their contracts and working practices are outside IR35, and that they have the evidence to prove it, long before a tax inspector ever opens their file.

And until the UK's legislators introduce an agreed definition of 'employment' for tax legislation, the issues relating to IR35 will never be resolved and the uncertainties for contractors will remain.

The current Labour government, faced as it is with the urgent need to increase tax revenues, seems intent on actions that will make the situation worse, as witnessed by recent proposals for the construction sector. Both main opposition parties have made vague promises to review existing business and employment regulation, but neither seems to have the heart to tackle IR35 head-on. So, in the current fiscal situation faced by the UK, it seems likely that IR35, in one form or another, is here to stay.

# Contractor Voices

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Every contractor has a different story to tell about their IR35 experiences, so we present here the voices of just a few who have spoken to ContractorCalculator about how IR35 has affected their contracting careers.

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Contractors, freelancers and interims have been steadily increasing in number during the decade since IR35 became law in 2000. Evidently, the prospect of higher taxes has not deterred newcomers to the sector, and early indications suggest that the impact of the current recession is swelling contractor numbers further. Many of those made redundant, or under the threat of redundancy, are choosing a lifestyle that provides them with greater control over their own destiny.

Newcomers to contracting now have access to a wealth of information and resources, such as ContractorCalculator.co.uk and the invaluable *Contractors' Handbook*, which they can use to help with their decision on becoming a contractor and how best to go about it. IR35 features prominently in most of these, so 'newbies' can make sure they understand relevant tax legislation, and how to ensure it doesn't become an issue for them.

For some contractors, IR35 is virtually irrelevant, as they have chosen a trading vehicle that means they already pay income tax and National Insurance Contributions (NICs) as if they are employed, and so the complicated rules and tests of employment do not apply. The price they pay tends to come in the form of reduced earnings.

Every contractor has a different story to tell about their IR35 experiences, so we present here the voices of just a few who have spoken to ContractorCalculator about how IR35 has affected their contracting careers.

## Starting out before IR35 hit the scene

According to IT contractor Darren Fawkes, before IR35 was introduced in 2000, running a contractor limited company required minimal effort. As an IT contractor in the City of London working mainly for banks, Fawkes thinks that his experiences are fairly typical of a great many IT contractors.

“My first couple of contracts in the late nineties were through an agency with my contractor limited company that I'd started as soon as I decided to go contracting,” explains Fawkes. “But the City is a small world and I soon started developing my own network, contracting direct with the client, and my company paperwork was minimal, about twelve invoices a year plus keeping track of my expenses.”

During 2000, when IR35 was introduced, Fawkes says he started to receive a lot more communications from his accountant, who had previously only sent reminders about returning VAT returns, accounts and other company paperwork. He also found that he was being bombarded with marketing from various tax schemes and offshore providers, claiming to be able to keep IT contractors like him outside of IR35.

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**That first meeting with his accountant was to lead to big changes, as Dodge incorporated soon after realising the risks to his personal assets if he remained a sole trader.**

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“I was never that concerned that IR35 would affect me, so I kept on doing what I was doing, but, on my accountant’s insistence, my paperwork was kept much more up-to-date,” he continues. “Knowing what I do now, ten years on, I was definitely a genuine contractor and outside of IR35 when it was first introduced, simply because of the way I ran my contracting limited company and the relationships I had with my clients.”

### Managing IR35 as needed

Others were more affected. “In the summer of 2001, I started contracting, although I then called it ‘consulting’, as a sole trader for a client I met on my MBA course,” explains interim management contractor Alan Dodge. “I was not even aware ‘contractors’ existed, let alone IR35, until I engaged an accountant to complete my first set of sole trader accounts.”

That first meeting with his accountant was to lead to big changes, as Dodge incorporated soon after realising the risks to his personal assets if he remained a sole trader. “I incorporated because I got a contract with a blue chip corporate that sued consultants at the drop of a hat,” he explains. “I also wanted to start building some branding in my company that wasn’t just about me.”

Yet IR35 was still not on his radar until his first meeting with the accountants a year after incorporating. “When I sat down with my accountant to hand over my first set of company accounts, he started asking me what seemed like odd questions – things like ‘do you have to perform all the duties for your client, or could someone else do them in your place?’. Even weirder, I thought at the time, was the question, ‘Can your client tell you what to do and when?’.

““ I realise now that the questions were an attempt to establish my IR35 status,” continues Dodge. “I kind of missed the point because I did not really understand why they were being asked, so did not answer them correctly in the right context. But nonetheless, I’ve always worked outside IR35 and have never been investigated.”

### Being inside IR35 was never an issue

Linda Marriot started her IT contracting career in 1995 as a limited company contractor, and as she cottoned on to what she viewed as the massively negative implications of IR35 immediately, had an unusual solution.

“I’d never been comfortable running my own contractor limited company, because of the time and the responsibility, but no one would hire me as a sole trader so I had no option,” she says. “When I read about IR35 and all the work being done by the Professional Contractors Group, I thought I can’t be doing with all this hassle, so went and worked as a contractor in Dubai for five years. No one much cared about limited company or sole trader and employment rights there!”

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I'm more concerned about what the Agency Workers Directive will mean to umbrella contractors like me and the likelihood that all these extra admin' burdens and regulations will end up driving many end-user clients out of the UK.

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On her return, Marriot found a much more mature contractor services marketplace, with many more options than when she left. "I discovered umbrella companies and wish I'd known about them before I left," she continues. "I didn't even bother to get an IR35 contract review, which seemed all the rage; I just joined an umbrella, paid the tax and claimed for my expenses."

And now? "Not a lot has changed," says Marriot: "I'm still with the same umbrella, my IT skills don't get the highest of rates but are always in demand, and IR35 is simply never on my radar. I'm more concerned about what the Agency Workers Directive will mean to umbrella contractors like me and the likelihood that all these extra admin' burdens and regulations will end up driving many end-user clients out of the UK. I never experienced anything like the level of regulation the UK has when I worked in the Middle East."

### Feeling the long arm of HMRC

Engineering geologist Michael George [not his real name – this has been changed at the request of the contractor] had been in business for twenty years when IR35 came on the scene, and it was purely bad timing that it became an issue for him.

"Throughout the 80s and 90s, I'd worked on infrastructure projects across the globe, either as an employee or as a partner in an engineering consultancy, quite often managing teams of contractors on a project," explains George. "I set up my own limited company in 2000 because I was told by a couple of engineering agencies that I would get no work as a sole trader, because clients did not want the risk."

Everything went well for five years operating as a one-man band, says George. Then the dreaded letter from HMRC arrived, informing George he was to be the subject of an employer's compliance review and to expect a visit from an inspector shortly.

“” Fortunately, being part-engineer and part-scientist by training, I'm somewhat anal about planning and anticipating when things go wrong," he continues. "I'd read everything there was to read on the ContractorCalculator website, got my contracts and renewals checked by a specialist, plus took out an inspection insurance alongside my professional indemnity."

Fortunately, according to George, there was a happy ending: "I literally get down on my knees and pray every day to thank the heavens that I was so thorough. The insurance paid for a specialist consultancy to manage everything, meaning I did not even have to meet the inspector – HMRC just went away because, according to my consultants, I had everything covered."

And the good news is that, terrible as it may have been at times over the last ten years, IR35 no longer holds the fear it once did and newcomers are not being discouraged, but are simply getting on with the job in-hand.

### Make sure you get a happy ending

There are still uncertainties over the IR35 status of many contracts. But if you put into place a methodology that stacks the odds in your favour, then there is every chance that, should an inspector call, your experience will be very like George's.

Plus, as Marriot's comments highlight, IR35 is simply not an issue for umbrella company and agency payroll contractors who pay tax at source through PAYE. And the good news is that, terrible as it may have been at times over the last ten years, IR35 no longer holds the fear it once did and newcomers are not being discouraged, but are simply getting on with the job in-hand.

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# 10x10x10: 10 years, 10 questions, 10 experts

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ContractorCalculator asked 10 questions of 10 experts from some of the leading contractor organisations and service providers to give us their insights into the first 10 years of IR35 and the time before them. And some of them have even been brave enough to make predictions for the next 10 years!

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Before IR35 burst onto the contracting scene 10 years ago, contractors appeared a homogenous bunch, with limited choices of service providers and little cohesion as a sector. Or were they? And how has that changed, if at all?

We've asked 10 questions of 10 experts from some of the leading contractor organisations and service providers to give us their insights into the first 10 years of IR35 and the time before them. And some of them have even been brave enough to make predictions for the next 10 years!

There is no doubt that IR35 had a major impact on contractors, the contracting sector and all its stakeholders. And, it appears, not all that impact was necessarily a bad thing, as the first cohesive voice for contractors and freelancers, the Professional Contractors Group, emerged in response to the threat.

## *Question 1: IR35 was born 10 years ago. Did it become a unifying force for contractors?*

**Julie Stewart, Elected Board Member, Professional Contractors Group**

“If we tried to run the same kind of online campaign today that we did in the summer of '99, we'd fail because everyone would think it was a scam,” jokes 27-year IT contracting veteran and Elected Board Member Julie Stewart of the 10-year-old Professional Contractors Group. But, on a more serious note, she comments: “It was one of the first ever internet movements, where 2,000 mainly IT, oil and gas contractors pledged £50 each after a freelance lobbyist noticed something in the small print of the finance bill.”

But IR35 was no joke. And that attention to detail resulted in the creation of the Professional Contractors Group (PCG), originally a one-platform pressure group that has evolved into a trade and professional organisation. It now has almost 20,000 members and is arguably the first unifying force seen in the disparate and eclectic mix of freelancers and contractors that makes up the sector in the UK.

According to Julie, even if PCG's core objective of abolishing IR35 was realised, the organisation would still go on, probably stronger than before. “There is still plenty of legislation that impacts on contractors and freelancers for PCG to challenge and influence,” she says. “Plus, clients and other stakeholders will always need education about contractors and freelancers and the benefits they can bring to an organisation.”

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It appears that after 10 years of IR35 the legislators in government, the Department for Business, Innovation and Skills, the Treasury and HMRC have learned very little about the UK's flexible workforce.

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### Question 2: *Was IR35 a difficult child in its early years?*

**Phil Richards, BFC A Chartered Accountants**

“ Accountancy support for UK contractors has evolved through three distinct phases – prior to IR35, during IR35's launch, and the period after its launch,” explains accountant Phil Richards, Head of Small Business at BFC A Chartered Accountants. “In the nineties, contractor limited companies faced the same issues in that pre-internet and paper-driven age that any microbusinesses did.

“Then, from the announcement on 6th March 1999, we entered a period of fear, uncertainty and doom, what we like to call ‘FUD’,” he jokes. “This FUD period lasted for at least two years, where the focus was on avoiding IR35 through increasingly Byzantine tax-inspired schemes. In fact, these simply wasted a huge amount of energy, rather than effectively tackling IR35 head-on.” Richards is convinced that it was Dave Smith of Accountax, and his influential IR35 Defence Strategies book, who started the final phase, which was the movement of addressing IR35 as an holistic employment law and tax issue.

“Although for genuine contractors, there is now considerably less doubt and uncertainty over their status under IR35,” says Richards, “a review of IR35 would be very welcome. However, judging by the recent proposals in consultations about taxation and employment status in the construction sector, it appears that after 10 years of IR35 the legislators in government, the Department for Business, Innovation and Skills, the Treasury and HMRC have learned very little about the UK's flexible workforce.”

### Question 3: *What impact has IR35 had on contractors' finances – has IR35 had any silver lining?*

**Tony Harris, ContractorFinancials**

As Tony Harris of independent financial adviser ContractorFinancials explains, contractors have seen huge changes, in particular to pension planning, over the past 10 years: “In the 90's the biggest factor that restricted tax efficient pension investment was the relatively small salary that was drawn out of the company, dividends being the preferred income route. Thankfully as advisers we could exploit a so called ‘de minimus’ rule on behalf of our clients that allowed up to £6,000 each year to be invested into an executive pension, irrespective of the actual level of salary drawn. However in 1998 the then Chancellor Gordon Brown abolished these freedoms in favour of the strict age related allowances that had previously applied to personal pensions”. And according to Harris, many contractors suddenly found that the amount they could transfer into pensions had plummeted, meaning that their retirement planning simply stopped.

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We now had a pensions solution to IR35 as contractors could invest a significant percentage of their increased salary with no deductions to the taxman

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But when IR35 was introduced, it forced contractors caught by the new legislation to pay themselves substantially higher salaries and suddenly pensions became the ideal mechanism to save tax today and invest for tomorrow. It seems incredible that IR35 could benefit anyone but, as Harris explains: “We all breathed a sigh of relief upon studying the IR35 rules and reading that company pension contributions were allowable over and above the 5% expenses allowance. We now had a pensions solution to IR35 as contractors could invest a significant percentage of their increased salary with no deductions to the taxman”.

Pension investment had the effect of significantly reducing the pain felt as a result of IR35 whilst also potentially bringing forward the prospect of an earlier retirement. “Post-pension simplification in 2006 there is in effect no limit to what an employer can invest on an employee’s behalf. Contractors who have savings to live on or a working spouse who can pay the day to day bills can now have their contractor limited company invest virtually all of their contract income with no income tax or National Insurance Contributions (NICs)” continues Harris. “IR35 had some unlikely positive side effects as many contractors have now built-up significant pension nest eggs as a result.”

#### Question 4: IR35 – what’s in it for clients and recruitment agencies?

Crawford Temple, Professional Passport

“IR35 is just one of the huge number of new government regulations in the last decade that have led to massive duplication of effort, and resulting costs, to the entire contractor supply chain” claims Crawford Temple, CEO of contracting sector compliance body Professional Passport. He bases his claim on his long experience in operational management and compliance within both the contracting and financial services sector.

“Examined objectively; contractors’, agencies’ and clients’ objectives are all the same,” continues Temple. “First, the client wants the best contractors for their assignments. Next, the agency wants its books filled with the best contractors as this allows them to gain more client assignments. Then, contractors want to be able to assess the real value of any assignment available. Clarity on IR35 status allows all these objectives to be achieved and ensures contractors are paid what they are worth.” The value chain works best when each member understands the others’ roles and pressure points.

“Unfortunately, HMRC exploits this breakdown of understanding in the contractor supply value chain and is currently focusing on the end-user client as the weakest link,” he continues. “IR35 references are appearing in new legislation such as the Agency Workers Directive and Preventing Illegal Working indicating that it is here for the long term” he says. “Even though now is not the time to be increasing the regulatory burden on business or to be extorting higher taxes, that’s the likely scenario we will be seeing.”

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I was used to promoting the agency as ‘IR35’ friendly, but I’ve found that there have been very few assignments where the contractor has raised the issue of IR35

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### Question 5: *How do recruitment agencies get involved in IR35 issues?*

**Ashley Cooper, Parc Ellis**

Ashley Cooper, of IT contractor specialist recruitment and employment agency Parc Ellis, has worked in both global and local agencies during his career of more than a decade. Despite keenly following the IR35 debate to help the contractors on his books clarify their IR35 status, Cooper has witnessed remarkably few IR35 incidents.

“When working for some of the blue chip agencies, I was used to promoting the agency as ‘IR35’ friendly, but I’ve found that there have been very few assignments where the contractor has raised the issue of IR35,” explains Cooper. “At Parc Ellis, we’re a tight-knit team of recruiters, all from corporate backgrounds, and running our own business makes us even more acutely aware of the pressures on the contractors who entrust their livelihoods into our care.

“Yet despite all the work I do to keep abreast of IR35, ensuring that I understand fully what a contractor needs in their contract and how to manage a client’s expectations accordingly,” he continues, “I hardly ever find IR35 to be an issue when placing a contractor in a role. This is in part because we tend to deal mainly with very experienced limited company contractors who clearly already have the knowledge required to manage IR35, or recently with brand new contractors who tend to opt for an umbrella solution for their first contract.”

### Question 6: *What’s the most important factor when evaluating a contractor’s IR35 status?*

**Kate Cottrell, Bauer and Cottrell**

Former HMRC manager Kate Cottrell, co-founder of IR35 consultancy Bauer and Cottrell, is in no doubt about what now matters most for a contractor’s IR35 contract status; indeed, it is the one thing that has been behind all key IR35 case law to date. “Working arrangements, or as some contractors prefer to call them working practices, are what defines a contractor’s IR35 status,” she says.

“Even the most robust IR35 ‘friendly contract that excludes control and supervision, includes an unfettered right to substitution and repudiates any mutuality of obligation, can be made worthless if it does not actually represent the reality of the working relationship with the end client,” continues Cottrell. “At the outset, contractors need to show that they are operating on a genuine business to business basis and should ensure that the end client recognises this.

“It is important too that their actions do not lead to them being seen to be integrated and part and parcel of the end client’s workforce. I often see cases where the initial contract began as a clear outside IR35 situation but then later roles changed as

It is the one thing that has been behind all key IR35 case law to date. “Working arrangements, or as some contractors prefer to call them working practices, are what defines a contractor’s IR35 status

did the relationship with the client putting it clearly inside IR35 and an IR35 contract review that does not consider the working practices is, in my opinion, not worth the paper it is written on.”

Cottrell, who questions claims that IR35 has not been entirely effective over the last ten years, points out that HMRC currently holds the upper hand in the IR35 Special Commissioners and High Court cases. HMRC has won more than twice as many cases as contractors. “It is clear that recently there has been a lack of policing of IR35 by HMRC and consequently this has led to some contractors not properly considering their IR35 status and I have seen a move towards ‘sham’ contracts,” says Cottrell. “There is no such thing as a ‘bullet-proof’ IR35 contract, unless it reflects the reality of the working practices and many contractors don’t realise that IR35 needs to be considered for each and every contract including all extensions and renewals.” And poor understanding of IR35 basics has led many contractors to believe, erroneously, that they are outside of IR35. “With HMRC’s new powers and enormous committed spend on compliance work there are tax, penalty and interest time bombs waiting to happen,” warns Cottrell.



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Contractors are also increasingly taking precautionary measures, such as getting contracts checked and taking out investigation insurance. This can only mean a reduction in risk for contractors.

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### *Question 7: We've seen a lull in IR35 cases in the last six to 12 months; so where have all the tax inspectors gone?*

**Carl Whittaker, Qdos Consulting**

“We've defended over 1,300 contractors in IR35 cases brought by HMRC in the last 10 years, and have compromised over just five,” explains Carl Whittaker of Qdos Consulting, which specialises in IR35 and legal matters for contractors throughout the UK. “We've fine tuned our responses and so has HMRC. This now begs the question: has it all been cost effective from HMRC's perspective?”

According to Whittaker, the number of IR35 cases has dropped in the last 12 months, a fact confirmed from other key IR35 legal practices and consultancies ContractorCalculator has spoken to in the run up to IR35's anniversary. What does this mean? Whittaker, who also works extensively with construction sector clients, proposes one explanation: “I've seen many of the key employment status specialists in HMRC move from the mainstream contracting sectors to the construction sector.”

The shift in focus bodes well for contractors, as do other observations from Whittaker about the contracting sector. “Genuine contractors are taking greater responsibility for their status and are much more willing to take advice,” he says. “Contractors are also increasingly taking precautionary measures, such as getting contracts checked and taking out investigation insurance. This can only mean a reduction in risk for contractors. The best IR35 defence is the one that pre-empt's an investigation and never gets to the courts.”

### *Question 8: HMRC – after IR35, where will tax inspectors go next to raise the money HM Treasury so desperately needs?*

**Derek Kelly, Parasol**

Much of the contractor market is now largely self-regulated, as contractors have learned, often with the assistance of the IR35 service industry, to be clear about the IR35 status of every contract,” explains Derek Kelly of the Parasol family of companies, which includes ClearSky Accounting. “But I would send the message to the Chancellor, and his successors, that we'd all like to see IR35 tidied-up, with greater clarity and the mystique removed.

“However,” he continues, “there is considerably more certainty now for genuine contractors, even though IR35 is clearly not the easiest to understand piece of legislation on the statute book. And although IR35 has caused some contractors to consider an umbrella company as their trading option rather than a limited company, the explosive growth in umbrella companies has largely been down to end-user clients pushing employment rights risks away, rather than wholesale acceptance by contractors of their IR35 status.”

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Contracting now has greater acceptance as a viable way of working, and genuine contractors have made the choice not to value the so-called benefits of employment above the freelance lifestyle, taking more responsibility for their own destiny.

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With self-regulation by limited company contractors having reached a form of equilibrium, and any future tax 'yields' from concerted HMRC campaigns likely to be small change compared to the Treasury's needs, Kelly can see other rich seams coming under the spotlight. "Income shifting has not yet completely disappeared, umbrella expenses may come under greater scrutiny and higher earning contractors using tax-efficiency schemes are losing the exchequer the sort of sums that will attract serious attention," he explains. "Not only that, but labour-only subcontractors in the construction sector are coming into the spotlight, and my concern is that we will see many of these contractors driven into the black economy."

**Question 9: How did contracting change when IR35 was launched, and how has it evolved to where it is today?**

**Roger Sinclair, Egos**

Although the oldest umbrella company is estimated to be around 20 years old, most contractors pre-IR35 worked through their own limited companies. And, according to Roger Sinclair of contractor specialist legal consultancy Egos, at the time they faced a similar set of legal challenges to those faced by most small businesses. "But there were a few exceptions," he explains. "In many ways, contractors still tended to act more like employees, and many of the legal disputes, in addition to those relating to commercial contract law, centred around premature termination, and the enforceability of restrictions in agency contracts which sought to prevent contractors dealing direct with clients."

The last 10 years have been hugely defining for the contracting sector. "Contracting now has greater acceptance as a viable way of working, and genuine contractors have made the choice not to value the so-called benefits of employment above the freelance lifestyle, taking more responsibility for their own destiny. And they mostly have an expectation that, in return for shouldering that responsibility, they should enjoy the benefit of paying less tax than employees." Sinclair emphasises that, in order for the UK to remain competitive in the global economy, the independence and flexibility of contractors must be maintained, with agencies and clients being prepared to play a bigger part in accommodating contractor needs, especially those relating to contractors' IR35 status.

““ Some contractor contracts did change very quickly when IR35 was introduced, and they have evolved to provide a measure of protection, alongside other measures such as working arrangements and the nature of the contractor's own business,” says Sinclair. “But, we've seen string of new legislative measures from government, such as the Managed Services Companies legislation, which was a tacit admission of the failure of IR35, the CIS scheme and other construction industry proposals designed to drag more people into the net of being taxed as though they were employees, regardless of their own choices,” says Sinclair.

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Companies using contractor services have changed, but not enough, and too many still try to treat contractors either as employed workers or commodities and not as the skilled service partners genuine contractors should be.

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“As a result, a great many contractors have been put in, and remain in, the position where they have to continue to calculate, on an ongoing basis, whether the risk and uncertainty of contracting is worth the reward.”

**Question 10: *Is IR35 a symptom of a wider problem afflicting the contracting sector’s stakeholders in government and end-user clients?***

**Martin Hesketh, Brookson**

With extensive client-side experience before he joined contractor service provider Brookson, a move that happened to coincide with the early days of IR35, Martin Hesketh is convinced there is still a lack of joined-up thinking right through the contracting value-chain. “I used to manage teams of contractors when I worked for a global defence aerospace firm,” he explains. “When IR35 was first introduced, HR got involved because it was viewed as an employment rights issue, and procurement had their say as they claimed ownership of the contractual side. Both groups ignored the key issue of working practices, and I took this hard-won experience with me to Brookson.”

Hesketh is concerned that IR35 is actually the symptom of a much wider problem: “There is still a major lack of understanding about the flexible workforce, where it is heading and the contribution it makes to UK PLC. Companies using contractor services have changed, but not enough, and too many still try to treat contractors either as employed workers or commodities and not as the skilled service partners genuine contractors should be.”

Without doubt, government and its many agencies are the worst culprits at not **“** appreciating professional contractors’ contributions. In fact, they are steadfastly refusing to understand what a vibrant contracting sector can do,” continues Hesketh. “This is evidenced not only by the attempts to target contractors specifically with IR35 and introduce income shifting laws, but also by the ongoing stream of increasingly generic ‘catch-all’ legislation, such as the Agency Workers Directive. These laws will end up inappropriately labelling large parts of the flexible workforce; a workforce with the potential to create the most value in the economy over the next decade.”

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**It is possible that the next 10 years could be kinder to contractors and freelancers than the last.**

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### **What to make of all this?**

The clear theme running throughout experts' contributions is that IR35 is here to stay and that, for genuine contractors prepared to invest a little time and money, there is significantly reduced risk of their contracts being found to be within IR35.

And despite the contracting sector being larger than the entire NHS workforce (PCG research estimates the UK has 1.4m contractors), there is clearly a great deal more education to be done on the benefits contractors and freelancers bring to clients and the UK economy.

However, with shifts in the UK's political direction expected in the next year or so, and the increasing publicity by industry bodies and service providers, it is possible that the next 10 years could be kinder to contractors and freelancers than the last.

# IR35 Worries??



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# IR35 Defence diary

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Your IR35 defence diary could provide the ammunition your representative needs to get a ruling in your favour, and to prevent you from paying out a potentially six-figure sum in back taxes, interest and penalties.

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If you are genuinely outside of IR35, then an HMRC inspection may be a worrying and time-consuming nuisance, but it should hold no nasty surprises. To support your response to any enquiry, it's good practice to create and maintain a personal 'IR35 defence diary'.

Keeping records on an ongoing basis means that, if you're challenged by HMRC to provide details of your day-to-day activities perhaps as much as six years in the past, you've got the information you need to prove you were not inside IR35 in a readily accessible format.

And, if the investigation gets serious and you find yourself in the Tax Chamber facing a hostile HMRC inspector, your IR35 defence diary could provide the ammunition your representative needs to get a ruling in your favour, and to prevent you from paying out a potentially six-figure sum in back taxes, interest and penalties.

## An IR35 defence diary – who needs one, and why?

If you are a contractor working through your own contractor limited company on a contract that you, or your IR35 adviser, consider to be outside of IR35, then you should definitely create and maintain an IR35 defence diary.

When HMRC investigates, inspectors can go back as far as six years into your career history. And who can remember exactly what they were doing and how they did it six months ago, let alone six years? By keeping a diary, you'll have recorded the day-to-day details that might be needed to prove you were working as an independent contractor in business on your own account, and not a disguised employee.

In tax investigations, contracts are only seen as part of the story. So, because HMRC now focuses very heavily on your working practices when trying to establish your employment status, it's those day-to-day details of how you work with your client that matter.

## HMRC tests of employment

When an inspector is evaluating your employment status for to determine whether you are in fact a disguised employee, and therefore inside of IR35, they will look at three key areas:

- Your contract with the agency or end-user client
- Your business as a whole, the history of your contractor limited company and how you operate it
- Your day-to-day relationship with your client – your actual working arrangements, in other words.

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But what does not get recorded, unless you make a conscious effort to do so in a diary, are the key conversations, meetings, phone calls and everyday chatter that point to the true relationship between you and your client.

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Your working arrangements, or how you interact with your client, is the most important element of your IR35 defence, but it can also be hardest to prove, especially six years down the line, unless you have kept an IR35 defence diary.

### What you should keep in your diary

It's really important for you to keep records of all those things that don't get captured by your usual 'paperwork'. Normally, your contract, letters and emails, invoices and company administration are all recorded either electronically or in hard copy.

But what does not get recorded, unless you make a conscious effort to do so in a diary, are the key conversations, meetings, phone calls and everyday chatter that point to the true relationship between you and your client.

So, demonstrate how careful you are in running your own business (ie not being a disguised employee) by recording the following in a hard copy or online diary, a dated notebook or similar:

- Key telephone conversations, particularly during negotiation (this is good practice anyway, in case you have a dispute over what is meant by specific contract terms)
- The content and outcomes of key meetings, particularly meetings to review progress, as you can clearly differentiate your business' involvement from that of the client' employees on the project team
- Conversations with your client project manager, which relate to progress on the project, changes in priority or focus; in fact, anything that confirms your status as an independent professional contractor and not an employee.

Of course, you should also keep important emails and other relevant correspondence – this might include the minutes of meetings written by the client. And be sure to ask for amendments or clarifications if the documents do not reflect your status as a genuine contractor. If you don't, you can be sure that HMRC will go through your client's records and pick up on anything they deem to be incriminating.

In fact, when putting together your diary, it is worth regularly reminding yourself that a strong case to place you inside IR35 can be built on what you see as flimsy evidence, but which others might consider absolute proof that you are a disguised employee.

### Staying organised

Ideally, every contract you work on should have its own dated IR35 compliance file, which would hold all relevant documents – contracts, timesheets, invoices, letters, faxes and emails, plus your day-to-day diary and dated notes.

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**Never be tempted to represent yourself in a tax investigation. Contractors who have lost IR35 cases having to pay up in excess of £100,000.**

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You should keep your records as a hard copy file in your office at home, or keep an electronic file – including scans of hard copies – in a form that you can easily burn onto a CD or load onto a memory stick.

Crucially, all these records should be stored somewhere easily accessible for six years. Then, if you receive notice that you are being investigated by HMRC, you can hand the files over to your investigation advisers and forestall an investigation before it really gets underway.

And just a note of caution – never be tempted to represent yourself in a tax investigation. You would probably never even consider appearing in a court of law, or completing your tax return and filing your company accounts without professional assistance, and an investigation is no different. In fact, it can prove a lot more costly, with contractors who have lost IR35 cases having to pay up in excess of £100,000.

# Ten point plan for staying outside IR35

Based on the 10 years that the team at ContractorCalculator have been gathering news and reporting on IR35, we have compiled a list of the top 10 issues you should be thinking about on every contract.

Based on the practical lessons learned by industry experts and a decade of case law, if you are a genuine contractor running your own limited company and you invest some time, and a relatively small sum of money, in your IR35 defence, then you have little to fear from IR35 or the intermediaries legislation.

But this does not stop 'have-a-go' HMRC inspectors dragging you into time consuming, long drawn out, expensive and stressful investigations. Ideally, therefore, your aim should be to pre-empt an investigation and stop it in its tracks before it even gets off the ground.

Matt Boddington of Accountax puts it this way: "A successful IR35 defence is not about winning; it's about avoiding a case in the first place." Carl Whittaker from Qdos Consulting agrees: "The best IR35 defence is the one that pre-empts an investigation and never gets to the courts." If you take on board this clear message from two of the top experts on IR35, you could save yourself a whole world of pain. However, it's not that straightforward. Contracting sector experts universally agree that there is no 'silver bullet' to the IR35 problem – so no single factor will get you out of IR35.

Based on the 10 years that the team at ContractorCalculator have been gathering news and reporting on IR35, we have compiled a list of the top 10 issues you should be thinking about on every contract. When reading through these tips, remember that IR35 does not apply to you, or your company, but to each discrete and specific contract. So you should be building the IR35 defence whilst negotiating each contract, and throughout the contract period.

Here's what you should be thinking about:

## 1. Are you really in business in your own right?

Any HMRC inspector and, if it gets that far, a judge in a court, will be assessing all the available evidence to determine whether you are in fact a small business owner, or just a tax-avoiding 'disguised employee'.

You can help to prove to them you are in business in your own right by:

- Having a business name, brand, website and stationery that says the business is more than just you
- Making sure you have an office at home, which of course is your permanent workplace, and that it looks like an office, too, with:
  - o A desk and office chair
  - o Computers, printers and other office equipment
  - o Filing cabinets and storage solutions for software, reference materials and business correspondence, etc
  - o Business insurance for your home office business assets
  - o Business telephone, fax and broadband, as appropriate

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Record keeping is neither difficult nor time consuming, and is certainly not beyond any contractor. So, for the sake of a small amount of effort, keep those records and have them ready for your adviser if HMRC comes calling.

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- o Claims made for a proportion of utility bills and any repairs and renovations, according to HMRC guidance
- Regularly assessing your skills and paying for training when appropriate – this can include investing in professional association membership, trade and professional publications’ subscriptions and reference books
- Using your business name, brand and website as marketing materials for marketing campaigns, such as maintaining a web presence
- Having concurrent clients.

The fact that the former Special Commissioners, now Tax Chambers, and the High Court are keen to hear evidence in order to create a ‘notional contract’ to determine your employment and thus IR35 status, means the more of the above you can genuinely supply as evidence, the higher your chances of pre-empting an investigation.

## 2. Do you keep accounting and other records like a business?

The accounting profession’s online blogs are full of stories about accountants receiving a client’s records in a bin liner the day they are expected to represent their client during an HMRC inspection. There are three lessons from this scenario:

- You can legitimately ask for a postponement of an HMRC visit if you have a good reason
- Keep good records, or pay someone to do so on your behalf
- If your poor record keeping comes to light later in a Tax Chamber or court, it is likely to be used as evidence that you are not a professional businessperson, but an employee.

Record keeping is neither difficult nor time consuming, and is certainly not beyond any contractor. So, for the sake of a small amount of effort, keep those records and have them ready for your adviser if HMRC comes calling.

## 3. Do you have investigation insurance or the cash equivalent?

Tax investigation insurance is essential for contractors running their own limited companies. Although it is neither a legal requirement – like public and employee liability insurance – or a condition put in place by clients – like professional indemnity insurance – it should be seen as an essential part of your contractor’s armoury.

Of course you can represent yourself in a Tax Chamber or even the court, but as Alan Brill and his wife discovered in the Larkstar Data case, going it alone is likely to backfire. So, for the sake of the cost of the policy, which is often bolted on to other policies and therefore very good value, the peace of mind is invaluable.

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**Contract reviews by IR35 specialists can cost anything from under a hundred pounds to several hundred, depending on what you are asking for.**

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Should you decide not to opt for investigation insurance, then the other option is to be sure you have several tens of thousands in savings to pay for the professional advisers you are likely to need to defend yourself against HMRC's claims for back taxes, interest and penalties.

#### **4. Did you get your contract checked by an IR35 specialist?**

So, you are well and truly in business in your own right and have the right level of protection for the next contract. The interview goes well and the contract is on the table; what should you do next?

Contract reviews by IR35 specialists can cost anything from under a hundred pounds to several hundred, depending on what you are asking for. And top quality accountants include contract reviews by specialists as part of their service for their limited company contractor clients.

Poorly worded contracts are often used as evidence by HMRC that a contract is inside IR35. Professional fees to defend against an HMRC investigation can cost many thousands or tens of thousands of pounds. And a successful ruling by HMRC can cost hundreds of thousands of pounds. So, when you do the maths, getting a contract review is not much of an expense when you consider the alternative.

#### **5. Is your agent or client IR35 friendly?**

Nobody says that negotiations can be easy, but if you've chosen the professional contractor career path then you need to learn how to get tough during negotiations. Because all the financial risk of IR35 is borne by the contractor, most agents and clients have little or no interest in the legislation – why should they have, as it costs them nothing?

But agents and clients can often be the elements that determine whether the contractor is inside or outside of IR35, which can have huge financial implications for the contractor. So get your agency and client onside early. If you think they won't play ball by amending contracts or signing confirmations of arrangements, then it is probably best to walk away rather than pay a hefty price in future.

#### **6. Do you behave like a contractor, and not an employee, every day on every contract?**

Most contractors were once employees, and remember what it was like to belong to a team, to be asked to be the fire warden, to go on first aid courses, to enjoy the company canteen, to organise social events, etc.

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**When evaluating your IR35 status, HMRC inspectors will want to establish that your working patterns and relationship with your client point to an employment relationship.**

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You must forget all the above, and many other things besides, if you want to stay outside IR35. If you are a contractor, then you are no different from any other supplier to the business. You are just one more business-to-business (B2B) supplier with no employment rights. So if anyone tries to offer you any employee benefits, even something as simple as a pass to the front door, decline politely and explain why.

### **7. Did you get a 'Confirmation of Arrangements'?**

When evaluating your IR35 status, HMRC inspectors will want to establish that your working patterns and relationship with your client point to an employment relationship. And they may be trying to do this for contracts you worked on up to six years ago. Without this information, HMRC will be able to make you dance to their tune, as they may have already gleaned details of your working relationship from your old clients. And HMRC will use even the flimsiest of evidence to prove that you were a 'disguised employee'.

But if you have drafted a one-pager about what you do on a day-to-day basis, which is countersigned and dated by your client project manager, then you have the evidence you need to convince HMRC that throughout your contract period you were acting in a business-to-business relationship with your client, and not as an employee.

### **8. You've had a contract extension, did you get the renewal checked?**

IR35 applies to specific contracts and not to an individual contractor or their limited company. So each renewal also requires an IR35 check, because contractors frequently find themselves changing their role within their client's business. It is essential that this be reflected in the contract renewal.

There are many examples of contractors who were told many months or years ago that they are outside IR35, who have since gone on to fall foul of the taxman. Could you be at risk? Even if the original opinion was correct, subtle differences in the way you work or the way in which the law is interpreted might mean that you working inside IR35 right now. Get it checked!

Always get a professional opinion from an independent contractor expert who specialises in IR35 and contractor issues – high street accountants and generalist solicitors are unlikely to be familiar with all the important nuances. They might be good 'GPs', but what you need is an expert IR35 surgeon to cut out what you don't need and introduce what is missing.

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Never, ever consider attending any meeting with HMRC alone. There are many examples of tax inspectors asking deliberately leading questions that they then turn into official records of meetings that totally incriminate the contractor.

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### 9. Do you know what you should do with correspondence or contacts from HMRC?

Don't respond yourself or try to deal with it. Instead, take a copy and forward it to your accountant or tax adviser, then diarise a follow-up call a few days later to confirm they have received what you sent and to get a timescale from them on what is to be done. And it's worth you having a note somewhere handy of the insurer underwriting your tax investigation policy in case you need to contact them direct.

Never, ever consider attending any meeting with HMRC alone. There are many examples of tax inspectors asking deliberately leading questions that they then turn into official records of meetings that totally incriminate the contractor.

### 10. Have you made the right financial planning decisions as a businessperson?

It's incredibly easy to forget the longer-term financial implications of decisions made now. And contractors with a portfolio of contracts that fall inside and outside of IR35 may wish to take advantage of periods when their contract is inside of IR35 to invest in their pensions. As Tony Harris of ContractorFinancials explains: "Following pension simplification in 2006, there is in effect no limit to what an employer, ie the contractor's own limited company, can invest on an employee's, ie the contractor's, behalf."

As a contractor, you have no employer quietly stashing cash away for the benefit of your retirement – it is totally up to you to make provision for any future financial needs. The same goes for any periods where you might not have to worry about IR35 at all, such as when you cannot work for health or other reasons. You need to have savings set aside to see you through.

Talking to an independent financial adviser is essential.

### IR35 has gone away, hasn't it? Or at least is on the way out, right?

Not on your nellie! IR35 is with us to stay for at least the coming months until the next election, and it is almost certain that, whichever party or parties form the next government, the legislation or something similar is likely to remain on the statute books.

Some of the taxman's attention has of late been diverted away from mainstream contractors into the construction sector. But HMRC has £1 billion to spend on compliance, which translates into an awful lot of inspections, so contractors are likely to be under the spotlight again very soon.

However, if you take on board these ten tips, then the chances are good of you batting an inspection away, before it gets serious.

# The real impact of IR35

PCG is the voice of freelancing and represents the interests of freelance contractors in the UK. Since its formation in response to the original IR35 proposals, PCG has lobbied for consistency, clarity and common sense in the tax system. IR35 has led to numerous distressing, costly and time consuming HMRC investigations into legitimate freelance businesses. The results of a September 2009 survey of PCG members by ComRes reveals:

**7%**

of surveyed freelancers experienced an IR35 investigation, nearly half of which lasted five or more years.

**74%**

of freelancers who experienced an IR35 investigation felt intimidated by HMRC.

**Only 4%**

of freelancers investigated would describe HMRC as "transparent".

**85%**

of freelancers investigated confirmed that their personal life was affected by the process.

**Just £9.2 million**

The total amount directly raised by IR35 investigations between the tax years 2002/2003 and 2007/2008, as revealed by a request under the Freedom of Information Act by PCG.

**"Tax investigations are invariably stressful. Without the help of my PCG adviser it would have been a complete nightmare. I say this to every contractor I meet, join PCG, it's worth every penny!"**

**Paula Mick, Freelance contractor and PCG member**



**From just £120 per year, PCG members benefit from:**

- ✓ Tax investigation insurance
- ✓ Tax and legal helplines
- ✓ Contract templates
- ✓ Tools to help you manage your own business
- ✓ IR35 analysis and manuals
- ✓ Access to discounted services
- ✓ Active community
- ✓ The fruits of PCG's lobbying work



**Can you afford not to join? Find out what we can do for you.  
Call PCG on 0845 125 9899 or visit [www.pcg.org.uk](http://www.pcg.org.uk)**

# IR35 ten years on and ten years hence?

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To paraphrase the then Chancellor, IR35 was designed to make those workers leaving employment on a Friday and starting as a consultant on a Monday pay a fair amount of tax.

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In the same way that no-one in the late nineties could have predicted that IR35 would be law by 2000, the same is true for the next ten years, in which we may see a change of government that has a very different perspective on how to manage and tax the flexible workforce. It is quite clear that over the last ten years the original objectives of IR35, as stated by Gordon Brown, have only partially been realised. To paraphrase the then Chancellor, IR35 was designed to make those workers leaving employment on a Friday and starting as a consultant on a Monday pay a fair amount of tax.

## IR35 does work – in a fashion

The figures released by HMRC about the tax take from IR35 following a Freedom of Information request earlier this year by the Professional Contractors Group don't tell the whole story. For example, they don't take into account the substantial tax revenues generated via the umbrella company sector from a great many contractors whose contracts are inside IR35, or who are sufficiently fearful of HMRC that they choose not to run a contractor limited company.

The consensus of service industry experts and contractors alike is that IR35 is a poorly thought through piece of legislation, which it is virtually impossible for HMRC to police. As a result, contractors with some nous and the willingness to invest a small amount on good professional advice find it relatively easy to avoid the pitfalls of IR35. And even when the IR35 status of a contract is not entirely clear, it can still be worth a contractor taking a risk. For example, for contractors earning £500 a day and who stand to lose £15,000 per year if their contracts are found to be within IR35, the temptation is great to chance their arms.

## Be careful what you wish for

There are contractors and contractor sector organisations that want IR35 abolished. This is a laudable objective, but legislative history warns that they should be careful what they wish for. If IR35 goes, then it will be replaced with something else to ensure that government, of whatever party, can still raise the same or more revenues from contractors. That something may be creating a definition of a personal service company and slapping National Insurance Contributions on dividends, or something else equally nasty. Or that something could be even worse, more unworkable and more expensive than IR35.

The new Agency Workers Regulations undergoing a consultation this month may also have as-yet unknown implications for how IR35 continues to be applied within the contracting sector. Although the legislation is not due to be implemented until 2011, the consultation over the draft legislation ends in December, and already we understand from sources close to the Department for Business, Innovation and Skills that the two sets of rules will be closely intertwined.

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The most significant event likely to impact on contractors following the introduction of IR35 ten years ago will be the outcome of the next election.

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### 2010 election results

The most significant event likely to impact on contractors following the introduction of IR35 ten years ago will be the outcome of the next election. We have been told by the Tories that they are planning widespread reviews of business legislation, to include IR35 and the Agency Workers Directive; they appear to have a deeper understanding of the flexible workforce and the benefit it brings to UK PLC than does the current Labour government, but it would be a brave person indeed who predicted that this would lead to more favourable taxation rules for contractors.

We know that the Liberal Democrats show a level of sympathy and understanding of contractors and the flexible workforce, and there have even been Lib Dem attempts to repeal IR35 by an early day motion. But even if the Lib Dems formed the next government, or became bigger hitters in a hung parliament, it is unclear what they would replace IR35 with.

And let us not forget that the electorate can be fickle and we could see the incumbent administration elected for another term, possibly leading to further tinkering with IR35 and the taxation of contractors.

### Increased taxes may create 'brain drain'

The elephant in the room is the mushrooming public sector debt burden, which will drive the agenda of whatever political party gains office next year. Taxes are likely to be increased, not repealed or reduced, and contractors have traditionally been regarded by the Treasury and HMRC as soft and lucrative targets. So contractors may even find themselves being squeezed even tighter, and looking back on the recent years of IR35 as the 'good old days'. And with the rest of the nation under pressure, complaints are likely to be ignored.

Contractors are knowledge workers whose skills and businesses are highly mobile – there is no expensive plant or facilities physically chaining them to the UK. If pushed hard enough, some might choose to move to regimes more welcoming and appreciative of their talents. This could seriously affect the chances of UK PLC pulling itself back into shape. On the other hand, in a free market economy, there are plenty of highly skilled overseas specialists ready to step into their shoes in the UK. And with the government's new points-based visa rules, there is an easy mechanism for the government to fill skills gaps.

For the next few months at least, IR35 will remain, as is likely to continue at least into the first few months of any new government. So, the challenge for contractors will be to continue to contract compliantly.

# IR35 – Crunching the numbers

Surely IR35 can't be that bad? Well, it is, and if you regularly work inside IR35 throughout your contracting career, it could cost you the same as buying a decent house.

If your contract is found to be inside IR35, it can cost you a great deal of money. But exactly how much – surely IR35 can't be that bad? Well, it is, and if you regularly work inside IR35 throughout your contracting career, it could cost you the same as buying a decent house. That's a lot of money to hand over to the taxman every year when, with a little effort, you can prove to the taxman that you are genuinely in business for yourself and that your contracts are not inside IR35.

The first step is to work out how much IR35 will cost you by using our online IR35 Calculator. You can input your current rates and work out your net pay, what you take home, depending on whether or not your contract is inside IR35. This domain name takes you directly to our IR35 Calculator:

<http://www.contractorcalculator.co.uk/IR35Calculator.aspx>

## IR35 Calculator

Determine the impact that IR35 has on your net income.

Simply enter your contract details below and click calculate:

[Advanced Calculation >](#)

Rate: £

Rate type:  hourly  daily

IR35 status:  outside  inside

Type in your gross hourly or daily rate – the rate you are paid by your agent or client – and then hit 'calculate'.

For the sake of a little extra effort and cash, you could be taking home 25% more of your earnings.

## IR35 Calculator - Results (Inside IR35)

Understand the impact of IR35 on your NET income

[Show calculations for if my contract was outside IR35](#)

- Your current net monthly income is **£3,843**
- Avoiding IR35 would increase your income by **£991 (25%) to £4,834**
- Increasing your rate by **£15 (31%) to £65**, earns you the same as someone outside IR35
- You can take an IR35 compliant contract for **£10** less and still receive the same income
- If you avoided IR35 and took an extra **12 weeks holiday** you would still earn the same
- To get the same income via permanent employment would require a salary of **£67,471**.

As you can see from the screenshot of the results, if your contract is inside IR35, you can lose up to 25% of your income, or have to work 12 weeks more each year to achieve the same as if your contract was outside IR35.

Rate per hour	Monthly take-home pay	Impact on monthly take-home pay after taxes when inside IR35
£20	£2,075	Decreases 20% (£432)
£30	£3,161	Decreases 22% (£719)
£40	£4,020	Decreases 21% (£860)
£50	£4,834	Decreases 20% (£991)
£75	£6,871	Decreases 19% (£1,320)
£100	£8,908	Decreases 18% (£1,648)
£125	£10,945	Decreases 18% (£1,977)

The table shows the range of what a typical contractor earns and the impact of IR35 on their monthly take-home pay.

When you are running your own contractor limited company and taking charge of your own earnings in a way not possible for employees, tax becomes just another expense that you can minimise – just like taking other costs out of your business to maximise your net income. For the sake of a little extra effort and cash, you could be taking home 25% more of your earnings.

# YOUR EXPERT GUIDE TO CONTRACTING

For recession-beating coverage of the key issues facing contractors and freelancers NOW, the brand new Contractors' Handbook will help you:

- ✓ Find and secure new contracts
- ✓ Understand IR35 and how it affects you
- ✓ Deal with problems when things go wrong
- ✓ Gain advanced marketing and sales skills
- ✓ Take control of your career and finances

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