IR35 and how it affects contractors

If you are a contractor and do not meet the "self employment" rules as defined by the Inland Revenue then IR35 is a very important consideration. IR35 took effect in April 2000 and means that the Inland Revenue can tax some contractors as though they were direct employees of their clients. This can result in contractors paying more tax which can in effect reduce their pay by up to 25%.

The reason IR35 was introduced was to prevent contractors from using tax avoidance methods such as using Partnerships and Personal Services Companies. The view of the Inland Revenue was that a significant number of contractors were often treated as being self-employed whereas they should have been regarded as employees of the client employing their services.

Whilst IR35 might not affect all contractors directly, they still need to be aware of the implications and protect themselves wherever possible. Unfortunately, there are no black and white rules as to who falls under IR35 and who doesn't so the best way of finding out for sure is to seek expert IR35 advice. Your working arrangements and contract will be reviewed by an IR35 consultant who has extensive experience in this area. Don't bury your head in the sand as this could have significant financial implications in the future.

If you do fall under IR35 then all fees earned are considered as your "salary" and NIC and tax will be deducted in the same way as if you were a direct employee of the client. The financial implications for the contractor is that more tax is paid and can typically expect to receive 20% less in their take home pay than a contractor who falls outside of IR35. Depending on your hourly rate this could equate to thousands of pounds each month. Using an IR35 calculator is a great way of determining how much IR35 will affect you and these can be found on many accountancy websites.

The best way to tackle IR35 is to be proactive and seek the advice of a company or individual trained in IR35 rules and regulations. A good IR35 expert will review your entire contract in order to ascertain your status. You can then be as prepared as possible when you start working for each client and know exactly how much you will be taxed each month. HMRC request that every contractor demonstrates "reasonable care" when conducting their tax affairs. If you do not comply with certain rules you could face a range of fines and in the most extreme cases, imprisonment. Therefore, it is important to get your contract checked for IR35 before you sign on the dotted line.

IR35 doesn't need to be a burden and there are many services available to ensure you comply with the right legislation and don't incur any fines or other penalties. The most important thing to do is take appropriate action and ensure that your financial and tax affairs are in order.

About the Author

Clearsky Accountants are a UK Contractor Accountant specialising in IR35. If you are freelancer ask them for a quote today.

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