

A large, stylized logo consisting of a pink lowercase "f" and a light blue lowercase "w" is positioned behind the main title text. The "f" is on the left and the "w" is on the right, both rendered in a thick, rounded font style.

# Limited Company Guide

## Service Summary - What is included in our fee?

### Set Up

- Form a Limited company at Companies House.
- Register your company for PAYE.
- Register your company for VAT.
- Register your company for Corporation Tax.
- Register your company for the VAT Flat Rate Scheme.
- Assist with opening a HSBC bank account or Barclays.

### Monthly

- Operate your payroll with payslips for each employee.
- Calculate and issue profit statement for your company.

### Quarterly

- Calculation & advice of VAT returns & payments.
- Calculation & advice of PAYE payments.

### Annually

- Issue and file P14's/P60 & P35 with HMRC.
- Issue and file P11d & P11d(b) with HMRC.
- Calculate and advise on Class 1A NIC payments.
- Prepare & file annual accounts with HMRC.
- Prepare & file Corporation Tax return (CT600) with HMRC.
- Prepare accounts for Companies House.
- Prepare Companies House Annual Return (AR01).
- Personal Tax Return for one person

### Your obligations to us:

- Send us copies of your invoices.
- Send us your expense claim form.
- Send us a copy of your company bank statements.
- Respond to letters and emails from us.
- Pay our fees each month.

## Step One.

### Company Set Up

Check it has been formed as you wanted:

1. The company directors are as you requested, there must be at least one director.
2. Company Secretary - small companies no longer need to appoint a Company Secretary, if you do have one, now is the time to check that it is who you requested. If you decide that you no longer wish to have a company secretary, simply complete a TM02 form and post to Companies House.
3. Registered office - this is the legal address for your company. Check that the company has been set up with the address you want.
4. Shares - the allocation of shares is normally done when the company is formed, check that the shareholder(s) are as you want.

## Step Two.

### Choose Bank Account

One of the first actions after the company has been formed is to open a company bank account. There are numerous banks, all very keen to open an account for you, however for simplicity and a great deal, it is unlikely that you will find a better option than using one of our recommended banks, HSBC or Barclays.

Contact freshwater office for details.

## Step Three.

If you intend to pay salaries then you must set up a PAYE scheme with HMRC.

There are several PAYE responsibilities you have as a director, the main ones being:

1. Deduct & pay to HMRC, income Tax and NIC from salary payments.
2. File Annual Returns to HMRC by 19<sup>th</sup> May after the end of the tax year
3. Report benefits & expenses paid to directors and employee by 6<sup>th</sup> July after the end of the tax year.

It is important that you get this right from the start; there are various penalties that can be incurred for not getting it right.

Contact the freshwater office for details

## BASIC FACTS

FOR 2012/13

### Step Four. VAT

VAT is a tax that is normally added to the value of your fees, currently the rate is set at 20%. So, if the invoice for your services is £1,000 you would add £200 (£1000 x 20%), making the total invoice £1,200.

You must register for VAT if the annual turnover of the company will exceed £77,000 (2012/13) – although we would recommend that you register, even if your turnover will not reach this threshold.

A benefit is the VAT Flat Rate Scheme – this is a scheme to simplify the operation of VAT and, in most cases will save you money.

The typical annual savings are in the region of £1,500 to £3,000. To join the scheme, your turnover should not exceed £150,000 per annum.

*freshwater offers this registration service free of charge to all new clients.*

There are several VAT responsibilities you have as a director, the main ones being:

1. Complete a VAT return every 3 months. This must be now done electronically, giving you more time and if you opt to pay by DD, more time to pay too.
2. The return is due approximately five weeks, following the return period. So, if the return is up to 31st December, the return is due by 7th February.
3. Pay any VAT owing, this is also due at the same time as the VAT return, so you have at least 5 weeks after the return period to make the payment.

### Step Five.

#### Corporation Tax

Soon after your company has been formed at Companies House, HMRC will issue a form 'Corporation Tax - New Company Details' – this will be sent to the registered office, so if this is not at your address, check that this form has been completed.

By completing this form HMRC will register your company for Corporation Tax; this is the tax payable on the company profits. Corporation Tax is currently charged on profits at 20% for small companies.

Company profits are generally calculated by taking away the business expenses (salaries, travel expenses etc) from the turnover. Freshwater offers this registration service free of charge to all new clients.

## Step Six.

### Insurance

Generally there are three types of insurance that you need to consider.

**Employer Liability Insurance** - this covers the employer against claims by an employee for injury etc. This cover is no longer legally required if you are the only employee and you own at least 50% of the shares.

**Public Liability Insurance** - to insure you against injury or death to third parties and damage to third party property as a result of your actions.

**Professional Indemnity Insurance** - to insure you against any claims made against you, for example, if your client suffers a financial loss as a result of your error or negligence.

If you require insurance, please give us a call at freshwater for further details

## Step Seven.

### Choosing an Accountant

**Communication** – speak to a few accountants, choose one that you can offer you expertise in your area of business

**Fees** – accountancy fees can vary widely and it can be hard

Contact the office for details and a free no obligation consultation.

## Step eight.

Chose freshwater as your accountant and feel total piece of mind and be assured that we won't let you down. With over 30 years of experience and all our partners have a BIG four Accountancy firm back ground so there is no compromise in quality.

## Step Nine.

### Invoicing

So that you can receive payment for your services you will need to issue an invoice to your client.

## Legally, an invoice must contain the following details:

1. Company name, address and registration number;
2. VAT number;
3. Invoice date;
4. Invoice number - this should be a consecutive number, although a prefix can be used if you wish;

## Step Nine. Invoicing (Continued)

5. Itemised breakdown, showing the chargeable period, rate etc.

**Self-Billing** - If you source your assignments through an agency, they may operate a 'self-billing system' – this will generate an invoice for you, so there is no need for you to issue one. In fact if you use a self-billing system, HMRC regulations prohibit you from issuing your own invoice.

## Step Ten.

### Expense

#### What can I Claim?

**There is no easy answer to this as all expenses must be 'wholly & exclusively' for the business.**

However, typical expenses that may be claimed include:

- Salaries
- National Insurance Contribution (Employer's)
- Employer pension contribution
- Business travel (including mileage and public transport)
- Accommodation whilst away from home on business
- Subsistence whilst working away from home
- Accountancy Fees
- Mobile telephone costs
- Postage and stationery
- Home office costs
- Business computer equipment and software
- Internet connection
- Technical books and publications
- Business entertaining
- Subscriptions to approved professional bodies
- Bank charges (if you are paying bank charges please give us a call!)

## Step Eleven.

### Salary

The level of salary to pay is something you will need to decide. Assuming that the IR35 rules do not apply to your contract, the two main options are whether to pay at the level of the tax & NIC free allowance (£7,488 for 2012/13) or a salary at the level of the National Minimum Wage (NMW).

### Step Eleven. Salary (Continued)

The NMW is set at £6.08 per hour, so based on a typical 37.5 hour week, this would equate to an annual salary of £11,856. Paying an extra £4,368 as salary will mean that you will pay PAYE of £750 and employees NIC of £512, adding in the employer NIC of £603 makes an extra £1,865 payable to HMRC.

However, paying a higher salary would attract Corporation tax relief of £994, so the net extra taxes payable would be £871 (750+512+603-994).

Clearly there would have to be good reasons why you would opt to pay an additional £871 in tax each year.

Contact the office for details

### Calculator

You now need to decide what annual salary you would like to be paid from your company. The most tax efficient salary would be one set at the earnings threshold which is £7,488 for 2012/13 (prorated if you have become a director part way through the tax year). Before confirming this you should take note of the following considerations:

1. The above assume that there is no written contract of employment in place between yourself and your Company. If you do the National Minimum Wage regulations will apply, this is currently set at £6.08/hour and based on a 37.5 hour/week this would equate to an annual salary of £11,856.
2. Do you make personal pension contributions? If so, you will only get tax relief up to the value of gross salary paid, this issue may however be solved by making pension contributions through the company;
3. Do you hold any insurance policies linked to the level of salary paid? (eg. IR35 insurance) If so, you may need to pay yourself a salary above a certain level for the insurance to be valid.
4. You must earn in excess of £5,564 this tax year to earn a qualifying year for state pensions.

## Step Twelve.

### Dividends

Dividends are a portion of post tax profits paid to the shareholders, the owners of a Limited Company. Dividends are always declared and paid net of notional tax at a rate of 10%.

This 10% tax credit is not actually paid by the shareholders or the company- it is treated by HMRC as a deemed payment of tax. Before declaring a dividend the company should ensure that there are profits available to support the dividend

### Step Twelve. Dividends (Continued)

payment. Once this has been satisfied the company holds a board meeting to declare the dividend.

*freshwater will calculate the profit and prepare the dividend vouchers on your request.*

### Taxation of Dividends

Provided that the recipient of the dividends is not a higher rate tax payer then no further tax will be due on the dividend.

Higher rate tax payers will be liable for an additional charge on any dividend that exceed the higher rate threshold.

Please call us at freshwater for further information.

## Step Thirteen.

### IR35

IR35 was introduced in April 2000 and is designed to combat what HMRC call 'disguised employment'. The aim is to increase the tax paid by people who set up their own company instead of working as a normal employee.

Where a company provides the services of a member of staff to a client (either via an agency or directly) and the terms are such that without the intermediary (company), the individual would be an employee of that client, then the IR35 tax treatment is triggered.

The deciding factor is to establish whether you are classed as 'employed' or 'self employed'. There is no statutory definition of employment; however HMRC will look at several factors to help decide which side of the fence the engagement lays.

Contact the office for details



## Step Fourteen.

### Tax Returns

As a director, HMRC will expect you to complete a personal Tax Return each year.

The Tax Return will include details of all your income, such as salaries, interest, dividends etc. Allowable deductions such as pension and charity contributions are also declared.

### Step Fourteen. Tax Returns (Continued)

The Tax Return is normally due with HMRC by 31st January after the end of the tax year, this is also the date any outstanding taxes are due.

freshwater can complete the tax return for you as part of our service, provided we receive it by 30th September after the end of the tax year and it is relatively straight forward, failing that, our normal fee for clients is £85+VAT per return. The charge may also apply if you join part way through the tax year.

Tax Returns are normally issued by HMRC in April each year, if you have not been issued with one, or an advice letter saying that you need to complete one you should contact HMRC to request one.

## Step Fifteen.

### Timetable

This is a summary of the various dates you should be aware of:

**Companies House** - Abbreviated Annual accounts to be filed at Companies House within 9 months of the year end. (Earlier dates apply to the first year).

**Annual Return (AR01)** - is prepared at the anniversary of the company's incorporation, it is then due 28 days after this date.

**HMRC** - Full Annual Accounts & Corporation Tax Return (CT600) to be filed online with HMRC within 12 months of the year end. (Earlier dates may apply to the first year).

**Corporation Tax** - payment of Corporation Tax is due 9 months after the year end. (Earlier dates may apply in the first year).

**VAT Returns and payment** are due at the end of the month following each quarter. As an example:

Quarter ending 31st March	Due by 7th May
Quarter ending 30th June	Due by 7th August
Quarter ending 30th September	Due by 7th November
Quarter ending 31st December	Due by 7th February

Contact the office for details freshwater

## **PAYE**

**P35 & P14's** are due after the end of each tax year. They should reach HMRC by 19th May after the end of the tax year.

**P11d & P11d(b)** are due after the end of each tax year. They should reach HMRC by 6th July after the end of the tax year.

### **Step Fifteen. Timetable (Continued)**

**PAYE/NIC** deductions from salary should be paid no later than the 22nd of the end of the month/quarter, if paying electronically. Assuming that the company is eligible for quarterly payments they will be due by:

Quarter ending 5th April	Payment due by 22nd April
Quarter ending 5th July	Payment due by 22nd July
Quarter ending 5th October	Payment due by 22nd October
Quarter ending 5th January	Payment due by 22nd January

If you do not pay electronically the payments are due 3 days earlier.

**Class 1A NIC** - this relates to National Insurance on certain benefits in kind such as company cars. If this applies the payment is due by 22nd July following the end of the tax year.

### **Step Sixteen.**

Financial Management can be used to cover a wide range of topics, however, in relation to contractors and consultants this mainly covers the following areas:

- Retirement planning
- Pension Transfers
- Income Replacement
- Personal Protection

Please call us at freshwater where we will be able to introduce you to a leading financial advisor who is authorised and regulated by the Financial Services Authority.

## Step Seventeen.

### Checklist

1. Check over the company formation documents
2. Open a company bank account
3. Arrange to have your contract reviewed
4. Register a PAYE scheme with HMRC
5. Register for VAT
6. Apply to join the VAT Flat Rate Scheme
7. Register for Corporation Tax
8. Purchase any relevant insurance policies

Engage freshwater as your accountant and we will take care of points 1-7.

## Step Eighteen.

### Detailed Guide to Expenses

We have detailed some of the common expenses that you may wish to consider. Please take a few minutes to read through this guide and check that you are complying with any conditions for claims that you may be making.

### Background

Expenses are allowed for expenditure that you need to incur to run your business. The exact type and level of expenses can be very complicated and it is important to read this guidance and act accordingly. Expenses incurred by the company must be 'wholly and exclusively' for the purpose of the business.

Where the non-business purpose is merely incidental to the business purpose, a claim is still possible. If any expenditure has a dual purpose, then this expenditure will generally not be claimable. An example is clothing, you need to wear clothing whether you work or not, so the dual purpose prevents a claim.

### Salaries

A salary paid to the director (assuming they are the fee earner for the company) will be an allowable expense, together with the employer National Insurance Contributions (NIC). If the contract is not caught by the IR35 regulations then you are free to pay whatever level of salary you wish. We would normally suggest that a salary is paid at least equal to the NIC threshold of £7,488 (£624 per month).

A higher salary can be paid such as, in line with the National Minimum Wage rate, currently £6.08 per hour. On average this works out at around £11-12,000 per annum

## Salaries to the Company Secretary/Partner

Whilst in theory this is possible, in reality this can be quite hard to justify. You can pay the going rate for secretarial support etc but this generally will not amount to very much.

Typically, the support work for a contractor's company will be minimal, say 1 hour per month. At a market rate of say £10 per hour you are looking at an annual salary of just £120! Our advice would be to leave this; the new Companies Act has removed the requirement to have a Company Secretary from 6th April 2008.

## Home Office Costs

The easiest way to claim for this is to claim the flat allowance of £208 per annum, no receipts are required and this is allowed by HMRC if you use part of your house as an office. Simply claim on your expense form and it will be included in your accounts.

## Step Eighteen. Detailed Guide to Expenses (Continued)

### Travel Costs

Tax relief is available for travelling/accommodation expenses, which involve two types of journey:

- Journeys which you have to make in the performance of your duties; and
- Journeys, which you make to or from a place you have to attend in the performance of your duties - but not journeys which, are ordinary commuting or private travel.

Relief is available for travel between home and a temporary workplace.

**A temporary workplace is where you go to perform a task of limited duration or for a temporary purpose.**

Whether you can treat the workplace as temporary depends upon how long you are based at one particular site or expect to spend at one site.

**In most cases a temporary workplace will be one where you do not, NOR EXPECT to be at, for more than 24 months.**

If you sign a twelve month contract (at a new location), then you will be able to claim for most of the travel/ accommodation costs involved. If, at the end of this contract you extend it for a further twelve months, then at this stage you expect to be at the site for a total of at least 24 months and so any claims for travel/accommodation would cease at the date you sign the contract. If you extended for just 11 months, you could continue to claim, because at this stage you do not expect to be at the site for 24 months.

There are some special circumstances that may affect any claims, please contact the office if you require further details:

- If you are only based at one site whilst working through your company and then you close the company, i.e. you only ever work at one site whilst working through your company.
- If you work at more than one site on the same contract
- If you generally work at various sites within a defined location (e.g. City of London)

## Mileage Allowance Payments

The following rates can be claimed for business journeys:

Per Tax Year	First 10,000 miles	Miles over 10,000
Cars	45p	25p
Motor Bike	24p	24p
Cycle	20p	20p

## Step Eighteen. Detailed Guide to Expenses (Continued)

### Example

Other forms of travel (train, bus, plane, etc) are also eligible, however ensure that you obtain receipts for the journeys. Please note that overuse of taxis are not generally accepted so please avoid excessive use.

### Accommodation

#### Hotels & Guesthouses

Where an employee stays in a hotel or guesthouse, relief is permitted in full for the costs actually incurred. As always the invoice should be in the company name and retained with the expense claim form.

#### Rented Flats

In many cases furnished accommodation (e.g. flats) can be obtained as a cheaper and more convenient alternative to hotel accommodation. Provided that the total cost of the accommodation is appropriate to the business need and is reasonable and not excessive, tax relief should be allowed. The cost will be accepted as reasonable where the total cost of providing the accommodation does not exceed the cost of hotel accommodation of an appropriate standard.

In all cases (hotels/guesthouses/flats) you may also claim for the provision of breakfast and an evening meal. The cost of a sandwich etc purchased on the way to a temporary workplace can be claimed, although this does not include lunch prepared at home etc.

If you are staying away from home due to business commitments you may also claim for a subsistence allowance of £5/night (£10/night overseas). This is intended to cover small incidentals such as laundry, newspapers etc.

### Mobile Telephones

The provision of one mobile phone is exempt from any tax charge. The exemption covers the telephone itself, any line rental and the cost of private calls paid by the employer on the telephone. Notes:

- The number of phones provided for private use is restricted to one;
- Mobile phones provided to members of your family and household are excluded;
- To qualify, the contract must be in the name of the company and paid from the company bank account.

### Internet Access

You can claim for the cost of Internet/Broadband access at your home subject to the following:

#### Step Eighteen. Detailed Guide to Expenses (Continued)

- There is no separate billing or record of access connections (if there is, then you can only claim for the business connections);
- No breakdown is possible between work and private connections;
- Private use is not significant;
- The contract must be in the name of the company and paid from the company bank account.

### Computer Equipment

If you require the use of a computer/laptop in order to carry out your duties then you can claim for the cost of providing one. If you are on the VAT Flat Rate Scheme (as we generally recommend) then you will only be able to reclaim any VAT if the total cost is in excess of £2,000.

### Childcare Vouchers

As a contractor, your company may be able to provide you with childcare vouchers, a popular method to pay for childcare. Up to £243 per month can be provided to each employee. There are two ways in which childcare costs can be paid from the company, via a voucher scheme or via a direct agreement with the childcare provider.

Your company can purchase vouchers from a childcare voucher scheme provider such as Busy Bees and issue these to the employees. The employee then uses them to pay towards childcare at a registered provider. The scheme provider will charge an administration fee, typically about 2-5% of the face value of the voucher.

This is where your company agrees directly with a registered childcare provider to purchase childcare and provide this to your employee. A simple letter of agreement between your company and the childcare provider is all that is needed here, stating the amount that your company agrees to purchase on behalf of the employee; a sample letter can be found at the on our Childcare Factsheet, available on our website.

Generally the voucher scheme is easier for the employee to use; however, there are additional costs involved due to the admin fees charged. Remember, which ever option you choose, the costs must be paid direct from the company bank account.

Conditions To qualify the following conditions must be met:

- The childcare vouchers can only be used at registered or approved childcare providers;
- The child or stepchild must live with you;
- The child or stepchild for whose maintenance you contribute (either in full or in part) is yours;
- The child qualifies, up to 1st September after their 15th birthday (16th birthday if they are disabled); and
- The child carer must not be related to your child, even if they are registered or approved, unless they run a childcare business and look after other children that they are not related to.

### Benefits

Assuming that you do not receive a large salary, you can benefit to the maximum amount of £243 per month, the tax savings can be generous, and the amount will depend on the top rate of tax you pay and how your company provides for the childcare. It is possible to save over £1,000 of tax each year.

### Pension Contributions

Pension Contributions made by your company to a pension scheme will no longer automatically be allowable for tax relief. From 6th April 2006, pension contributions can only be claimed if it can be shown that the contributions have been incurred 'wholly and exclusively' for business purposes. HMRC may try to establish whether the pension contribution has been paid for a 'non trade purpose', i.e. does the contribution benefit the person far more than the business?

HMRC have stated that they will not challenge an overall remuneration package and its split between salary and pension contributions. Provided the overall contributions do not exceed the annual allowance of £50,000 – there should not be an issue with making company contributions in excess of the salary paid. We would advise you to consult with your pension advisor prior to making any pension arrangements.



freshwater Limited are not authorised to offer advice regarding pensions and other investment products.

It would seem that HMRC would accept pension contributions as part of an overall package made up of salary and pension contributions. Remember that personal tax relief (for pension contributions) is capped at 100% of the salary paid. Currently there is not much difference in the tax benefit between contributions paid personally or by the company, although there is a marginal benefit for personal contributions in most cases.

## Training Costs

Work-related training costs can be paid by your company provided that the purpose of the training is to upgrade or enhance your current skills. If the purpose of the training is to gain new skills, the cost will be treated as capital expenditure and your company will claim Capital Allowances.

Notes:

- The training must be designed to impart, instil, improve or reinforce any knowledge, skills or personal qualities which are likely to prove useful when performing your duties.
- Costs associated with the provision of the training are allowable, such as travel and hotel accommodation.

## Insurance

By law, every employer must take out a policy for employer's liability insurance, which covers the employer against claims by the employee for injury etc. This cover is no longer required if the company only employs its owner and they own at least 50% of the shares. Other insurance's that you may consider taking out include:

- Public Liability Insurance – to insure you against claims from third parties that may sue if they have suffered from your actions.
- Professional Indemnity Insurance – to insure you against any claims made against you, for example, if your client suffers a financial loss as a result of your error or negligence.

## Medical Insurance

The company can pay for medical insurance (e.g. BUPA, PPP) however this would always be taxed as a benefit in kind, and the company would pay NIC of 13.8% on the cost. The policy must be in the company name or you will also be liable for personal NIC payments.



## Christmas Party/Annual Event

An annual event, commonly a Christmas Party, is an allowable expense for the company and you will not be taxed upon it providing you meet the following conditions:

- The total cost must not exceed £150 per head – if the cost is just 1p over then the whole cost will be subject to tax and NIC, not just the amount over £150;
- The event must be open to all staff, although in reality that will just be you!
- You may invite a partner, but if partners are invited, all staff must be entitled to invite a partner – invited partners will count for the £150 per head allowance.

## Business Entertaining

Business entertaining is **not** an allowable expense, whilst you can claim for any such entertaining the cost will be disregarded when calculating the taxable profits of your company.

## Miscellaneous Items

Other costs that can be paid by your company will include:

- Accountancy Fees
- Postage costs
- Stationery and computer consumables

## IMPORTANT

To avoid potential problems with anything you wish to claim for, it is vital that it is your company that makes the contract and pays for the expense you wish to claim for. This is particularly important when claiming for a mobile phone, internet connection, computer equipment and training costs. Where possible, obtain the receipt in the company name.

## Example

An employee would leave his employment on a Friday afternoon and return to work the following Monday to do the same job but not as an employee of the original employer. Instead he would be employed by an intermediary (a personal service company of which he would be a controlling shareholder/director) through which his services would be supplied to the original employer. The intermediary would invoice the original employer for these services and would receive a gross payment.

Through coming to the above arrangement the original employer would avoid paying Class 1 NIC at 13.8% and the (former) employee could arrange his payments between salary and dividends in order to minimise his tax and NI liabilities. The government therefore introduced anti-avoidance legislation known as IR35 in April 2000 with the purpose of countering this problem.

## Scope

The IR35 legislation applies to individuals who provide their services through an intermediary (usually a personal service company) where the income received for performing the services would have been treated as employment income had the individual contracted directly with the customer (without the intermediary).

The tests used in deciding if somebody is employed or self employed can therefore be used in deciding whether an engagement is caught or exempt from the IR35 legislation.

## Step Nineteen. Detailed Guide to IR35

### IR35 Guide

HMRC introduced IR35 to combat what they regard as 'disguised employment'. The aim is to increase the tax collected by individuals who set up a business on their own account. The common method that people set up in business is as a limited company but the legislation also covers all other business formats such as sole traders and partnerships.

IR35 is considered to be the main piece of legislation affecting contractors and freelancers as its implications affect the way in which they are paid and their tax liabilities. The purpose of this factsheet is to explain its rationale, scope, implications and to provide an understanding of the current developments in this area.

There is no straightforward test to determine the status of an engagement as there is no specific rules in statute – however the generally adopted approach is to look at the relevant factors of the engagement including the contract under which their services are performed and the actual working practices of the contractor.

To decide whether you are caught by IR35 you will need to consider your written contract together with the actual working practices. The relevant factors to consider are:

### Direction and Control

The amount of direction and control by the end client must be considered. It is not necessary to prove that the person carrying out the work is doing so under very detailed supervision because even professional persons can be operating under a general and overall framework of control from the end client.

- a) **What is done** - if a client can move the contractor to different areas of higher priorities will be an indicator of employment.
- b) **When it is done** - control over when the work is done may be an indicator of employment.
- c) **Where it is done** - when the contractor is required to work at the client's premises this can be an indicator of control, although if the work can only be done at the client premises, this may not be a factor.

- d) **How it is done** - this is a strong indicator of employment; it permits the client to prescribe the way in which the work is to be carried out. However, the absence of this level of control does not necessarily indicate self-employment, it is unusual for someone of a particular skill to be told how to do their work, but this does not make them self-employed.

**Contract Pointer** - ideally the contract should clearly state that the client has no right to direction, control, supervision etc. The contract can state that the client can make sensible requests but the contractor has no obligation to agree to them.

### Right of Substitution

Personal service is an essential element of a contract of employment. A person who has the freedom to choose whether to do the task themselves or hire somebody else to do it (on a reasonably unfettered basis) for them, is probably self employed.

**Contract Pointer** - a right of substitution written into all contracts in the chain is probably essential. The contract should state that the contractor is responsible for the completion for the services but should enable a right to use a suitably qualified person to provide the service. A clause to allow the client to be reasonably satisfied that the substitute has sufficient skills is acceptable.

### Mutuality of Obligation

Mutuality of Obligation would normally appear in all contracts, i.e. an obligation on each party to provide something. The internal guides for HMRC staff suggest that

they ignore this test when considering the IR35 status of a contract. This is quite a complex test but a Judge was critical of the HMRC's instruction to ignore it. This tests if any obligation exists between the client and the contractor. Contracting via an agency would not result in an actual contract between the client and the contractor although this test sees if there is an imaginary one.

If the client simply pays the contractor or agency for services then it may be that MOO does not exist and so not an "employment" situation. **Contract Pointer** – A self-employed person will have no expectation of further work at the end of a contract, a clear end date is desirable an exception would be if the contract was for a specific, clearly defined task

## Provision of Equipment

A contractor engaged to undertake a specific piece of work using their own tools and equipment will be a pointer to self-employment. If the contractor is provided with basic equipment this would be a pointer to employment.

**Contract Pointer** - the contract should not state that the client will provide basic equipment or cover training costs. The client provision of specialised equipment is acceptable.

## Financial risk

An individual who risks their own money, such as buying assets, bearing running costs and paying for overheads, will be self-employed. The risk of not being paid for an invoice would not qualify; this would be viewed as bad luck. Financial risk could also take the form of quoting a fixed price for a job, with the consequent risk of bearing the additional costs if the job overruns.

**Contract Pointer** - working for a fixed price, agreeing to correct defective work (at your cost), providing your own insurance cover will support a case for self employment.

## Basis of Payment

Employees tend to be paid by fixed rates, paid weekly, monthly etc. and may also be paid for overtime. Self-employed contractors tend to be paid a fixed sum for a particular job.

**Contract Pointer** - if you cannot charge a fixed price, try to issue your own invoice rather than relying on timesheets, steer away from using terms such as "overtime" and try to get any expenses included in the rate. If you must charge for expenses, include on the invoice and do not use the client's claim forms.

## Length of Engagement

Long periods working for one client may be typical of an employment but not conclusive. Regular working for the same client may also indicate that there is a

single and continuing contract of employment. A period of notice in the contract is more typical of employment contracts, so an absence of a notice period would point towards self-employment. If a period of notice is present, it should only be for a reasonable period.

**Contract Pointer** - ensure that the contract does not contain any clauses that prevent you from working for other clients at the same time. The contract should be able to be terminated early with a notice period of no more than one month.

## Business Set Up

To show if a person carries out business on their own account, it is necessary to take account of all aspects of the business form an overall view. If the business looks like a real business this will strengthen your case.

**Contract Pointer** - aspects that would help towards showing that you are a genuine business include, having business insurance, equipment, more than one client at a time, business telephone, stationery, other sources of income etc.

## Part and Parcel of the Organisation

The contractor should not be seen to be an integrated part of the organisation as this can weaken the case for self-employment status. The contractor should not use any benefits provided to the client's employees such as subsidised canteens, gyms, Christmas parties etc.

**Contract Pointer** - the contract should not cover areas seen in employment contracts such as reviews and disciplinary procedures.

Please refer to our free online IR35 checker for an initial assessment on our website (look under 'Free Resources'). It is highly recommended that each contract is reviewed to ensure that the obligations of IR35 do not apply. We recommend our partners, QDOS Consulting; we work closely with them to assist our clients.

## What happens if the contract fails IR35?

If, after a review of the contract and working practices, the engagement falls within the scope of IR35, HMRC sets out specific rules on how to calculate the tax that will be payable. You are required to pay the majority of your income (less a few qualifying deductions) as salary – this is referred to as their IR35 'deemed salary'.

This is calculated as follows:

	£	£
Turnover (net) from relevant engagements (cash basis)		A
5% Allowance (5% of A)		(B)
		C
Qualifying Expenses	D	
Pension Contributions	E	
D + E		(F)
C – F		G
Employers NI ((G- 605) x 13.8 ÷ 113.8)		(H)
<b>Gross Salary (G – H)</b>		<b>I</b>

The above 5% allowance is the amount of profit that the company would make assuming that the company incurs only qualifying expenses.

## Qualifying Expenses

The following expenses are qualifying deductions in calculating an employee's deemed IR35 salary:

- Travel, Mileage, Accommodation & Subsistence costs covered under Section 336 ITEPA 2003;
- Childcare;
- Employer contributions to an approved pension scheme;
- Employer National Insurance contributions;
- Approved professional subscriptions;
- Professional indemnity insurance.

Any other expenses incurred by the company will not be offset against the salary but will still be an allowable deduction from the profits made by the company which are subject to corporation tax. If therefore the company was to incur non-qualifying expenses greater than the 5% allowance – the company would make a loss for the year.

## Non-compliance

If an engagement is found by HMRC to have fallen within the scope of IR35 and the payments have not been treated in the above manner, HMRC would put this right by performing the above calculations on the income received by the intermediary in the relevant years meaning that the individual becomes liable to additional tax and NI – penalties and interest may also be charged on the additional tax/NI due as a result of the check.

## Umbrella Company Option?

Whilst the overall tax paid on an IR35 caught contract will be higher, it is still more tax efficient to operate through a limited company, rather than an umbrella company, the reasons for this include:

- Ability to save from the VAT Flat Rate Scheme, typical annual savings are £1,200+
- Lower administration fees, typical annual savings are £360 but can be over £1,000+
- 5% of the income is not subject to PAYE & NIC, typical annual savings are £2,250+
- Expenses prohibited by umbrella's such as mobile phone and internet can be claimed.
- One less company handling your money, after a series of umbrella companies becoming bankrupt this can be perhaps the most compelling reason.

## Developments

Since its introduction, IR35 has been a controversial piece of legislation among contractors and tax practitioners alike – this is largely due to the high costs of administration and the low revenues that it brings to the exchequer. The factors in determining the status of a particular engagement for IR35 is subjective and difficult to prove and as a result of this HMRC have not won many cases where they have challenged this.

Under the coalition government, the Office for Tax Simplification was asked to review IR35 and to suggest an alternative – however with little consensus on the correct route to tackle the problem, it was announced in the 2011 budget that the legislation was to remain the same but HMRC were to improve the way in which it is administered.

