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IR35 – A Practical Guide for Contractors

Status, Allowable Expenses & Tax Planning (UK)

What Is IR35?

IR35 (also known as the *Off-Payroll Working Rules*) is legislation introduced to prevent "disguised employment".

If you provide services through your own limited company (a Personal Service Company or PSC), IR35 determines whether:

- You are genuinely operating as a business (**outside IR35**), or
- You are effectively working as an employee (**inside IR35**)

Why Was IR35 Introduced?

IR35 was introduced in 2000 to tackle what HMRC calls "disguised employment."

At the time, many individuals were:

- Leaving employment on a Friday
- Returning on Monday doing the same job
- But now operating through their own limited company

By paying themselves a small salary and the rest as dividends, they could reduce:

- Income Tax
- Employee National Insurance
- Employer National Insurance

Meanwhile, they were working in a way that looked very similar to employment.

IR35 was therefore introduced to ensure that:

If the working relationship looks like employment, it is taxed like employment.

It is not about stopping contracting. It is about aligning tax with the *true nature* of the working relationship.

Who Does IR35 Apply To?

IR35 only applies where there is an intermediary between the worker and the client.

Typically this means:

- A limited company (Personal Service Company – PSC)
- Occasionally a partnership

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Limited Company Directors

Yes — IR35 absolutely impacts limited company directors who provide their own services through their company.

If a contract is inside IR35, the income is taxed under PAYE, broadly as employment income.
This can significantly reduce the tax efficiency of salary/dividend planning.

Sole Traders

No — IR35 does not apply to sole traders.

Why?

Because IR35 legislation only applies where services are provided through a company (or similar intermediary).

A sole trader:
- Is taxed directly on their profits
- Cannot split income into dividends
- Is already taxed as self-employed

If HMRC believes a sole trader is actually an employee, the issue becomes employment status, not IR35.

Simple Summary

Structure	**IR35 Applies?**	**Why**
Limited company contractor	✅ Yes	Income can be structured tax-efficiently
Sole trader	❌ No	Already taxed as self-employed
Umbrella worker	❌ No	Already taxed via PAYE

The Bigger Picture

Since April 2017 (public sector) and April 2021 (medium/large private sector), responsibility for deciding IR35 status often sits with the end-client, not the contractor.

This has made IR35 far more commercially significant than when first introduced.

What Determines IR35 Status?

IR35 is assessed at **individual contract level**, not company level.

The three key tests are:

Control
Does the client control:

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- What you do?
- How you do it?
- When and where you work?

The more control the client has, the more likely IR35 applies.

Substitution
Can you send someone else to do the work?

A genuine, unfettered right of substitution is a strong indicator of being outside IR35.

Mutuality of Obligation (MOO)
- Is the client obliged to provide ongoing work?
- Are you obliged to accept it?

A true contractor works project-to-project with no ongoing obligation.

Additional factors include:
- Use of own equipment
- Financial risk
- Ability to work for multiple clients
- Integration into the client's business

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Inside vs Outside IR35 – What Changes?

Area	Outside IR35	Inside IR35
Tax	Salary + Dividends	PAYE like employment
Travel to client	Usually allowable	Disallowed
Subsistence	Usually allowable	Disallowed
Pension planning	Useful	Very powerful
Expense flexibility	High	Limited

When inside IR35, you are taxed broadly like an employee — even if operating through a limited company.

Allowable Expenses – Inside IR35

IR35 - Allowable and Disallowable, the general rule is: If an employee couldn't claim it, neither can you.

However, some expenses remain allowable at company level:

Accountancy Fees
- Accounts preparation
- Corporation tax returns
- Payroll services
- IR35 reviews

Insurance
- Professional indemnity
- Public liability
- Employers' liability (if applicable)

Administrative Costs
- Companies House fees
- Banking charges
- Accounting software
- Confirmation statement fees

Employer Pension Contributions
This is the key planning tool.

Employer contributions:
- Reduce corporation tax
- Avoid PAYE and NIC
- Are not treated as personal income

For many contractors inside IR35, pensions become the most tax-efficient extraction strategy.

Disallowable Expenses – Inside IR35

The biggest impact is usually travel.

Travel to Client Site
The workplace is treated as a *permanent workplace*.

This means:

- No mileage claims
- No train fares
- No hotels
- No meal allowances

Even if the contract lasts only 6 months.

Subsistence
Daily meal allowances are not permitted.

Home Office (Against Deemed Income)
The company may claim the £6 per week allowance, but it does not reduce PAYE calculations.

Equipment for Assignment
Capital allowances may apply at company level, but they do not reduce deemed employment income.

Dividends as a Workaround
Income already taxed under PAYE cannot simply be extracted again tax-free.

Public vs Private Sector Responsibility

- **Public sector**: The end-client determines IR35 status.
- **Medium/Large private sector**: The end-client issues a Status Determination Statement (SDS).
- **Small private companies**: The PSC remains responsible.

The SDS must be provided before work begins, and a dispute process exists.

Practical Planning Points

If you are working inside IR35:

- Maximise employer pension contributions
- Keep company overhead lean
- Review salary/dividend mix
- Consider whether an umbrella company is simpler
- Ensure Status Determination Statements are reviewed

If outside IR35:

- Ensure contract wording reflects working practices
- Maintain substitution rights
- Avoid integration into client management structures
- Keep evidence of business independence

Is a Limited Company Still Worth It?
If all contracts are inside IR35:

- Your company still files accounts and corporation tax returns
- Profits may be minimal after PAYE
- Administration costs remain

In some cases, an umbrella structure may be more practical.

In others, retaining the company for future outside IR35 contracts makes sense.

A short review can clarify the most efficient route.

Common Misunderstandings

- "It's only a 6-month contract, so travel is fine."
- "I have a limited company, so I'm automatically outside IR35."
- "If I disagree with the client, that's the end of it."

IR35 is fact-specific and based on real working practices.

The GMS Approach

Tax planning should not be a once-a-year exercise.

At GMS, we focus on forward planning throughout the year — monitoring profit levels, reviewing thresholds and identifying opportunities before tax liabilities become fixed.

This includes:
• Managing higher rate exposure
• Timing capital expenditure strategically
• Structuring salary, dividends and pension contributions efficiently
• Reviewing profit regularly to avoid surprises

Quarterly reviews create visibility, control and informed decision-making.

Compliance is essential. Planning is where real value is created.

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