

What is so bad about IR35?

For almost two decades I have been harmed by the Government's assault on small professional services businesses. The system is grossly unfair in that it taxes you on money you do not receive and gives you no benefit in return. It also creates bureaucracy, barriers and burdens that stifle the growth of efficient small businesses.



- IR35 is an insult to honest people
- IR35 prevents the creation of new businesses
- IR35 intentionally taxes people on more income than they can receive
- IR35 allows no funds to be used to run and develop a business
- IR35 prevents you from hiring employees
- IR35 allows no funds to pay for normal employers' obligations
- IR35 causes bureaucracy, barriers and burdens

IR35 is an insult to honest people

HMRC seems to assume that the only reason people set up a business is to avoid tax. Their view is, presumably, prejudiced by their mission to collect as much tax as they can and the nature of some of their clientele.

So, why do we incorporate one-person professional services businesses? It's because that's what our clients expect. The procurement people at major corporations and Government departments do not expect to deal with John Smith, the guy who does spreadsheets in his bedroom. They expect to procure business-to-business from established companies.

The reality is that, in most cases, people want to set up and grow businesses because they want to create value for themselves, their co-workers, their clients and, generally speaking, for society at large including the taxman.

Most businesses operate honestly, overseen by independent honest accountants, and pay the correct amount of tax. I always operated my one-man company on a PAYE basis and promptly paid the right taxes and NI.

IR35 prevents the creation of new businesses

When in 2000 I found myself no longer required along with 189 other consultants from the same big firm, six of us decided to set up our own business. We incorporated, developed a great business model, analysed and forecast its financials, created materials, and appointed accountants.

The accountants advised us not to proceed because IR35 meant we might pay out more tax than the income we received. Here's the point.

- Like any consultancy business, some people would be earning fees whilst others who are not currently engaged would do useful things like selling, developing collateral, and doing the admin.

BUT

- We would need to remit PAYE, employers' NI and employees' NI on the money people are actually paid.

AND

- Under IR35 we would also need to remit PAYE, employers' NI and employees' NI on the money people are deemed to have been paid based on the fees they personally generated.

Unless most people are working for clients most of the time, projections showed that this could lead to over 100% of income being payable to HMRC.

We gave up. I spent the next 18 months looking for work in a market flooded with unwanted consultants.

IR35 intentionally taxes people on more income than they can receive

All businesses have unavoidable expenses. For a professional services firm, this would include accountancy fees, insurances including professional indemnity insurance, Companies House fees, Corporation Tax and essential IT. In my case, I reckon that requires around £3000pa plus whatever income/profit-related taxes apply.

The original version of IR35 allowed the company to retain some income to cover these essential expenses. This latest version of IR35, which is mandated and enforced in the public sector, is where it became grossly unfair. The company is now no longer able to deduct any amount for these business expenses. Therefore you pay tax on more money than you can possibly receive!

Here is my dilemma:

- Do I pay the business expenses from the company funds until it is in debt and ultimately bankrupt?
- Or do I pay myself all the company can afford but pay tax on a significantly higher deemed income, thus over-paying tax on my income?

IR35 allows no funds to be used to run and develop a business

But what if I wanted my company to spend on other things – like admin, advertising, specialist software, recruitment etc? How does the company pay the bills at times when there is no revenue coming in? The company has no way of building up any funds to pay for such things. It will be slowly drained by the inability to retain any income and certainly have no spare money to grow and develop the business.

IR35 prevents you from hiring employees

Likewise, there is no money to bring in further people and grow the business. The company could borrow money to recruit more people, but the barrier remains the same; IR35 inherently means the company makes a loss on its income so the bigger the revenue stream the bigger the loss – so, not much of an investment then!

IR35 allows no funds to pay for normal employers' obligations

And what about an employer's other obligations? An employee is supposed to receive holiday pay, sick pay, maternity/paternity pay, etc. So, where are the funds to pay for that if the company is unable to retain any income? I cannot go back to my past clients and invoice them for holiday leave.

The answer is simple – an IR35 worker is the only type of employee who cannot receive those fundamental employee entitlements. How ironic it is that, at a time when Government and the legal system seems to be strengthening workers rights to these entitlements, it is making them inaccessible to IR35 workers.

IR35 causes bureaucracy, barriers and burdens

The lack of trust at HMRC has led to a new regime, which is already mandatory in the public sector. The original scheme was easy enough to administer. The company simply made its PAYE calculations on the basis of the IR35 rules.

Under the new IR35 system, the client organisation is expected to administer systems for withholding tax and NI payments and remitting them to HMRC. This means the purchaser needs somehow to understand and calculate IR35 payments including PAYE and NI, and put in place the correct reporting and remittance processes. The contracting company needs to adjust its accounting and PAYE calculations to allow for the fact some payments have been withheld and already remitted to HMRC by its client. That must affect the invoicing and VAT processes as well. Quite frankly I'm still baffled about how that is supposed to work, otherwise I would have explained it better.

Judging by advertised opportunities, it looks like many organisations have avoided this burden by ceasing to hire people directly and only dealing with bodyshopping firms. The opportunities for genuine freelance professionals are shrinking.

Another impact is that many sought-after professionals have put their prices up to recover some of the losses brought about by IR35, increasing costs for their clients.

Anyone want to buy a management consultancy?

So, there you have it. IR35 is grossly unfair. It prevents the growth of new businesses and intentionally overtaxes the worker in exchange for no benefit whatsoever.

My one-man consultancy company is down to its last few hundred pounds and cannot go on much longer. Anyone out there want to buy it? One careful owner. All accounts, returns, taxes in good order for the past 14 years. Excellent company name and web domain.