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IR35 guide

In this guide, we run through the key things you need to know about IR35 as a self-employed professional, including the difference between 'inside' and 'outside' IR35, how IR35 status is determined and who is liable for applying the rules incorrectly.

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What is IR35?

In short, it's legislation that says "if you work like an employee, then you should pay the same kind of tax as an employee."

'IR35' is shorthand for tax legislation intended to prevent 'disguised employment'. This is where an employer hires the services of someone who works like an employee, but pays them for their work via an intermediary – usually a limited company – instead of through Pay As You Earn (PAYE) like a normal employee.

By 'disguising' the employment as a business-to-business arrangement, the employer is able to avoid paying Employer's National Insurance Contributions, Sick Pay, and Holiday Pay. The disguised employee can also potentially benefit from a reduced tax bill.

If HMRC later determines that an engagement was actually one of disguised employment, the IR35 rules give HMRC the power to issue demands for Income tax and National Insurance to be paid on the fees received by the employee during the engagement. This ensures that the individual pays employee-style taxes for employee-style engagements.

To prevent tax bills from being issued, the working arrangements for the engagement must be examined before it commences to determine whether the IR35 rules apply.

This is done by referring to a number of 'tests', which are established in case law. More information on these tests can be found in our guide.

[IR35 tests explained](#)

Who decides if IR35 applies?

Initially, IR35 status is determined by those involved in the engagement – this could be the freelancer or the client, depending on the size of the client's business.

The responsibility for assessing IR35 status belongs to the **client** if they are:

- A UK public sector entity, or;
- A business with a UK presence that meets the criteria of being a medium or large-sized business

Once they have completed their assessment, they must provide the contractor with something called a 'Status Determination Statement' (SDS). The statement formally notifies the contractor of the status decision and the reasons behind it. The SDS will also be passed down the supply chain i.e. to the agency (if there is one). -

[Why do clients get to decide my IR35 status?](#)



On the other hand, the responsibility for assessing IR35 status **belongs to the contractor** if their client is:

- A UK business that does not meet the criteria of being a medium or large-sized business, or;
- A business that is business based wholly overseas, regardless of size

Click 'read more' for an explainer on the 'small company exemption' and 'wholly overseas exemption' to the off-payroll working rules.

[Read more](#)



How do clients assess IR35 status?

There isn't one single method of determining whether an engagement is inside IR35 or not. The off-payroll working rules (the ones that make clients responsible for deciding if IR35 applies) only say that clients must take "reasonable care" when assessing the status of a worker.

In practice, this typically involves methods such as:

- Using HMRC's 'Check Employment Status for Tax' (CEST) online tool
- Engaging a specialist consultancy or legal expert to conduct an assessment
- Using software or digital questionnaires provided by a specialist consultancy or legal expert
- Conducting the assessment in-house without using software or tools
- Advertising the role as 'inside IR35' – also known as a 'role based determination'

What is CEST?

To help clients to make determinations, the government hosts a free-to-use tool named 'Check Employment Status for Tax' (CEST). CEST asks a series of questions and generates a status decision based on the answers provided.

While CEST primarily exists for clients, it can be used by anyone, including contractors. It's entirely anonymous – you don't have to put your name or company name into it, and HMRC keep no record of it. If you use it and it provides you with a result which says 'IR35 does not apply', keep it and share it with your client – it may help them get their own assessment right.

Is CEST the best way to determine IR35 status?



What does 'outside IR35' mean?

Being '*outside IR35*' means that the IR35 rules do not apply to your engagement, meaning that it is one of genuine self-employment for tax purposes.

This means that you can provide your services through your limited company and be paid a gross rate. Your earnings from the engagement will later be registered in your company tax return, rather than you being required to join a payroll and taxed at source.

Why do freelancers prefer working outside IR35?



You might work outside IR35 either because your client has assessed your IR35 status and determined that the rules do not apply.

Alternatively, if your contract is with a client who is exempt from the requirement to assess your IR35 status, you could have made the determination yourself. We explain more about determinations earlier in this guide.



What does 'inside IR35' mean?

Being '*inside IR35*' means that a freelancer or worker is a '*deemed employee*' for tax purposes. However, this doesn't mean that they become directly employed by the business they are working for.

Instead, the worker may be asked to join another payroll – this could be an agency payroll if an agency is involved in the work placement, or an umbrella company payroll.

For IR35 to apply, it must be determined that the relationship between a freelancer and their client is one 'of service' rather than 'for services'. These terms are used in case law. A contract 'of service' is akin to an employment; a contract 'for services' indicates a genuine freelance engagement. The distinction is made by referring to a number of 'tests', which, are established in case law.

Appeals

Contractors have the right to challenge their client's decision if they disagree with it. However, an appeal is not guaranteed to change the client's position.

Appeals are lodged directly with the client. Once an appeal is lodged, the client has 45 days to respond by either accepting or rejecting the appeal, as well as an explanation for their decision.

Bear in mind that clients are not obliged to agree with your appeal. In fact, IPSE data shows that the overwhelming majority of appeals submitted by contractors are rejected. Furthermore, there is no right to independent arbitration to settle status disagreements – once a client responds to an appeal, the contractor's only options are to proceed with the engagement or to walk away.

Nevertheless, if you feel your client has got the SDS wrong, it is still worth a challenge. You should provide evidence which demonstrates the engagement sits outside IR35. This

could be a contract review, or even your own CEST results, assuming its verdict was to determine the engagement is 'outside IR35'.

Umbrella Companies

An umbrella company is a business that employs temporary workers for work on contract assignments with other companies. They are commonly used by clients who have deemed an engagement with a contractor to be inside IR35, but do not want to employ the contractor directly.

How do I get paid when working through an umbrella company?

Like any engagement, you will agree a rate of pay with your client or agency – this is your *assignment rate*.

If you were placed in the role by an agency, your client will pay the assignment rate to the agency. After deducting an operating fee, the agency will then pass the funds to your umbrella company.

As your employer, the umbrella company is responsible for ensuring that deductions for income tax and employee national insurance are made, as well as for pension contributions (unless you opt out of automatic enrolment into their workplace pension scheme). The umbrella will also deduct their own operating margin, as well as employment costs – such as employer's national insurance, holiday pay and the apprenticeship levy, if they are eligible to pay it.

The remaining amount after these deductions are made is your *net pay* – this is your take home pay from the employment.

Why do umbrellas deduct employment costs and taxes from my rate?



Do I get employment rights when working inside IR35?

If your contract is 'inside IR35', it means you are employed *for tax purposes*. However, this doesn't automatically mean you are employed for the purposes of *employment rights*.

This is because employment rights are upheld by employers. But as contractor working inside IR35, you'll rarely be directly employed by the client you're working for.

Instead, you may be asked to work via an *umbrella company* and will sign an employment contract with them before work begins. So, the umbrella company is your employer – not your end client.

Employees get minimum levels of pay, rest breaks and holiday. Employees are also entitled to statutory maternity and paternity leave.

After two years of continuous employment, employees also qualify for statutory redundancy pay, stronger dismissal protections and more – [more on this on gov.uk](#).

So I get employment rights from my umbrella company?

As an employee of an umbrella company, you are entitled to employment rights and protections.

However, employment by an umbrella company is unlike traditional forms of employment, and the protections you receive do not apply to the organisation you are actually working for – your client. This makes accessing employment rights less clear when working through an umbrella company.

For example, [some contractors have experienced complications in receiving holiday pay](#), finding that funds originally intended to cover the cost of accrued holiday entitlement have 'timed out' and are retained by the umbrella company.

Who is liable for IR35?

If you work on an outside IR35 engagement, HMRC retains the right to investigate the status of the engagement until the end of the sixth tax year after payments began, depending on the circumstances.

If HMRC determines that the IR35 rules should have applied to the engagement, it will issue a tax bill for deemed Income Tax and National Insurance based on the payments made to your limited company.

Depending on the circumstances, a tax bill could be issued to your limited company, or to the 'fee payer' – either your client or agency.

- **My client is a small UK business or based wholly overseas**

In this case, you should have conducted your own assessment of your engagement's IR35 status. If HMRC decides to investigate and disagrees with your assessment, the deemed tax calculation will be issued directly to your limited company.

- **My client is a public sector entity, or a medium or large-sized business**

In this case, the engagement will be subject to the off-payroll working rules. This means that your client should have conducted an IR35 status assessment – taking 'reasonable care' when doing so – and issued you with a Status Determination Statement.

Even if a client takes 'reasonable care', there is still a risk that HMRC could disagree with a client's assessment. In this case, the **'fee-payer'** – usually the agency that connects the two parties – is held liable for unpaid Income tax and National Insurance.

However, if HMRC determine that:

- The engagement should have been deemed inside IR35, and;
- The client **failed to take reasonable care** when conducting their assessment

In this case, it is the **client** who is held liable for unpaid Income Tax and National Insurance.

Can my client or agency hold me liable if they receive an IR35 tax bill?

Frequently, a fee-payer will seek to insert an indemnity clause in the contract. This is intended to insure or 'indemnify' the fee-payer from IR35 risk, shifting it back onto the contractor as a condition of engaging them via their limited company.

In short, if the agency or client gets a tax bill after engaging you, they'll chase you for reimbursement.

The use of these clauses creates a difficult decision for contractors, who may have an offer of work rescinded if they don't agree to indemnify their client or agency.

My client has included an indemnity clause in our contract – what should I do?

We're yet to see an IR35 indemnity clause publicly tested in a court, making it difficult to say with certainty whether they are enforceable.

However, it's still a contract and if you sign it, the risk is there.

The good news is that many contractors have successfully negotiated these clauses out of their contracts. IPSE's [IR35 Spotlight 2024 report](#) found that, of those who were asked to accept an indemnity clause, 26 per cent said that they successfully negotiated the indemnity clause out of their contract – up from 18 per cent in 2023. This indicates that contractors are increasingly finding success in negotiating out these contractual terms.

Alternatively, if the client refuses to remove the indemnity clause, you always have the option of rejecting the contract and walking away.

You can read more about indemnity clauses in our blog below.

[More on IR35 indemnity clauses](#)

Summary

IR35 has always been a huge burden on contractors, and were made worse by the 2017 and 2021 off-payroll working reforms. For these reasons and more, IPSE is still deeply opposed to the changes to IR35 and continues to highlight the damage they are doing.

We need a simpler and fairer system – one that removes the need for IR35. That is our core campaigning focus now.

For now, there are a few steps – which have been discussed throughout this document – that may help contractors with these changes, which are summarised in the checklist below:

If you need support securing IR35 contracts, get your contract and working practices independently reviewed now. IPSE has a review service. Members get a discount	✓
Complete the CEST tool. If it determines that IR35	✓

doesn't apply, show the result to your client. If CEST doesn't put you outside IR35, don't worry – it's anonymous and you don't have to share it with anyone.	
If you disagree with your client's determination you can dispute it. Again, show them any evidence you have that IR35 doesn't apply.	✓
An inside IR35 determination may provide an opportunity to negotiate an increase in your day rate. If your client wants you on the project, they may be prepared to ease the burden by paying you more.	✓
The more you can demonstrate that you are in business-on-own-account, the more confident the client will feel about determining the engagement sits outside IR35.	✓
Remember the rules do not apply where the client is 'small', so if you want to avoid these difficult discussions with your clients altogether, and if it's feasible (which it isn't for many contractors) find small clients to work with.	✓
If you work via an umbrella company be very, very wary of eye-catching take home rates. It is probably a non-compliant umbrella and you could end up with a huge bill to pay at the end of it.	✓



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