



IR35 GUIDE FOR CONTRACTORS

IR35 COMPLIANCE FOR CONTRACTORS

Despite changes to the administration of IR35 from April 2021, the way in which it is determined remains the same.

Below we explain the main status tests that need to be considered to assess IR35, how to comply with the legislation and why. (Please note that this is only a brief guide; it is not intended to be a comprehensive analysis of employment status).

If you have any queries regarding IR35 or the below IR35 compliance guide, please do not hesitate to contact our consultancy department on 0161 962 6111 or info@jamrecruitment.co.uk

WHO IS RESPONSIBLE FOR IR35 COMPLIANCE?

The party responsible for IR35 compliance depends on when and with who you are contracting. Since 2000 when the legislation was introduced, it has been the sole responsibility of the contractor, but this is changing.

The responsibility for IR35 lies with the contractor if:

- You are providing services to a client in the private sector before 6th April 2021
- You are providing services to a client in the private sector which is classed as a small company under the Companies Act 2006 from 6th April 2021

The responsibility for IR35 lies with the end client/fee-payer if:

- You are providing services to a client in the public sector
- You are providing services to a client in the private sector which is classed as a medium or large company under the Companies Act 2006 from 6th April 2021

The off-payroll rules introduced in the public sector in 2017 and to be introduced to the private sector from 2021, mean that it will be the end client's responsibility to determine IR35 status. It will also be the fee-payer's responsibility to deduct the relevant tax and National Insurance from source.

Every member of the contractual chain inbetween is responsible for ensuring they contribute to the compliance of an engagement by passing the status determination statement along the chain.

THE KEY FACTORS WHICH DETERMINE YOUR IR35 STATUS

It is important to note that each working arrangement is reviewed on its own merits and all of the positive and negative elements of both the written contract and working practices will be weighed up in line with case law in order to provide a balanced opinion.

When considering overall IR35 compliance for the entire engagement, it truly is a mixture of different factors, not simply the written terms. You should ensure that any contract proven to be outside of IR35 also matches the working practices of that engagement. So, if the contract says you are expected to provide your own equipment for the services, you should make sure that you are not using any client equipment during the provision of the services. This is because when determining IR35 status, the working practices are seen to hold more weight or are also referred to as the reality of the engagement.

WHAT ARE THE IR35 TESTS?

Office Holders

Contractors, such as interim managers, who are personally appointed as ‘office holders’, i.e. those who take on management roles in their client’s business, must apply IR35 for tax purposes. HMRC defines an office holder as someone who holds a “permanent, substantive position which had an existence independent from the person who filled it, which went on and was filled in succession by successive holders.”

Job title alone will not determine a worker as an ‘office holder’ if the worker does not undertake the duties of an office holder.

Right of Substitution/Personal Service

A self-employed contractor enters into a contract to provide a service rather than personal skills and should be able to provide a substitute or engage a helper to provide the service. An employee on the other hand, would have to provide their services personally.

The right of substitution has been considered one of the strongest tests of self-employment since the case of *Chaplin v Australian Mutual Provident* (1978) which held that “...the power of unlimited delegation is almost conclusive against the contract being a contract of service.” This was upheld in the case of *Echo and Express Publications v Tanton* (1999).

Many contractors will argue that they never need to engage a substitute, perhaps because they never need one or because they do not know other contractors with the relevant skills to appoint, even if the need arose. Regardless if this is the case, HMRC will look to draw a ‘hypothetical contract’ and so it is vital that although the majority of contractors may never exercise it, the right to substitute someone else to undertake the work must be a genuine one. The substitute must be answerable to, and paid by, the company who originally undertook to complete the contract. Written confirmation from your end client would be valuable in an enquiry.

The client may retain the right to veto a substitution on reasonable grounds, however this should be limited to factors such as the qualifications/experience of the proposed substitute, or security issues.

Control

The degree of control exercised by the client over the services to be completed, as well as how, when, and where the individual does the work is highly important.

It is essential to demonstrate that the client has engaged the services of the contractor to provide a specialist service and that you have autonomy over the way the services are provided. To use an analogy that is often used; should you need the services of a plumber, you will contact the plumber, show the plumber what needs to be fixed, then the plumber is left to carry out the services using their own working methods. This is how the relationship between the contractor and the end client should be.

A self-employed individual may agree to perform a particular task at a specific time and place, but it is unlikely that they will be subject to any right of control by the client. An employee on the other hand, is likely to be told where and when the tasks should be undertaken. This is shown in the case of *Morren v Swinton and Pendlebury Borough Council* (1965).

This being said, for control to be relevant, it must be much more than merely monitoring or checking work. Unless a contractor is “tied hand and foot” to the client, then the detrimental level of control is not present [Chaplin v Australian Mutual Provident].

What

Control over what the contractor does will be clear, as he will be constantly advised by a manager or supervisor as to the work to be done. Where a client can move the contractor from job to job due to the changing priorities, there will be a right of control over what is to be done – this is a strong indicator of employment. [Stagecraft Ltd v Minister of National Insurance (1965)]

Where

Control over where the contractor does the work may be in the contract. A contract of service will usually provide the client with the right to require a contractor to work at a specific place. Where the tasks are to be undertaken at the client’s premises and the work to be integrated into the client’s premises, there is likely to be control. It is acknowledged, however, that certain services can, in reality, only be carried out at the client’s premises therefore this factor may be neutral.

When

Control over when the contractor does the work is obvious; an employee would be required to work set hours. A self-employed contractor would be expected to arrange their hours to suit the task and their own convenience.

How

Control over how the tasks are completed can be difficult. In the case of *Morren v Swinton Borough Council*, it was said:

“Clearly superintendence and control cannot be the decisive test when one is dealing with a professional man or man of some particular skill and experience. Instances of that have been given in the form of a master of a ship, an engine driver or a professional architect or, as in this case, a consulting engineer. In such cases, there can be no question of the employer telling him how to do the work, therefore the absence of control and direction in that sense can be of little, if any, use as a test.”

However, in reality, contractors with specialist skills and expertise will be likely to work with clients who have their own knowledge of these specialist areas. As such it is important that contractors retain a reasonable degree of autonomy over their working methods.

It should be remembered that the control need not be exercised directly, but that it can be delegated as was the case in *Global Planet v The Secretary of State for Social Security*.

Mutuality of Obligation (MOO)

An employer will try to make sure that their employees have a continuous supply of work and will also expect the employees to carry out the work when they require. A self-employed individual will do the work they are being contracted to do and will finish with no expectation of further work.

Although mutuality of obligation is a key determining factor surrounding IR35, it is worth noting that HMRC's lack of understanding and misinterpretation makes it difficult to mount a successful defence on this test alone. Additionally Judge Howard Nowlan in the 2011 UKFTT case of JLJ Services Ltd v HMRC stated,

“There is considerable case law in relation to this test, progressively indicating that the test is of diminished importance, or that it is indeed meaningless.....A touchstone of being an employee is the hope and expectation that there will be some relationship of faithfulness between employer and employee. In other words, the employer will generally endeavour to keep staff employed when work is short.”

Currently, much focus is being placed on non-mutuality of obligation during the contractual term and, as such, it is important that a contractor has the right to walk away from a contract early, if they so choose. Also see Right of Dismissal.

If no clear end date is included in the agreement, and there is no explicit non-mutuality of obligation clause, the contract could fail an assessment, however it would be necessary to look at the other positive elements of the contract. If there is no end date, it may be appropriate for certain contracts to terminate upon the completion of the services - this would be acceptable in cases where the contract is based on clear deliverables.

Financial Risk

Whether or not an individual is really in business on their own account is the most relevant test of all. A self-employed individual is responsible for how their business is run. Unlike an employee, they provide their own equipment, hire their own helpers, take responsibility for investment in management and have the opportunity of profiting from sound management in the performance of their task, and generally take a financial risk in operating.

Examples of financial risk are as follows:-

- The provision of your own equipment, office facilities, manuals and training.
- Having to indemnify the client against losses or damages due to your negligent acts or omissions.
- Being obliged to correct defective work at your own cost.
- Having to provide your own insurance cover, e.g., Professional Indemnity, Public Liability and Employer's Liability.

Other matters such as VAT registration, health and safety requirements, licences, advertising, etc. should be taken into account and help to demonstrate being in business on your own account. A limited company contractor should have all the normal trappings of a legitimate business in place.

Whether equipment and other facilities are provided by the individual can also be important. An employee will have all the necessary major items of equipment and facilities provided by their employer. The self-employed will generally provide their own equipment as shown in the case of *Ready Mixed Concrete (South East) v The Ministry of Pensions and National Insurance* (1968].

The more essential the equipment is to the work, the more important this factor becomes, i.e. a milk man who does not own his own float will not normally be accepted as self-employed.

HMRC will also take into account investments in skill, i.e. training.

If a contract contains clauses that stipulate the client will purchase any training or equipment (other than particularly specialised equipment) on behalf of the supplier, it is likely to fail an assessment.

Right of Dismissal

It is not normally the case that a self-employed person could be dismissed other than if they were in breach of the terms of their contract. HMRC see notice periods as being indicative of employment however reasonable notice periods are considered defensible.

A better indication of genuine self-employment would be to not have a notice period, but rather both parties be able to terminate with immediate effect. Although realistically this will be impractical for most commercial agreements. Although a lack of mutuality of obligation is a pointer towards a contract for services, this issue does not carry as much weight as it used to and in the case of *McManus v Griffiths*, Mr Justice Lightman said in relation to a three-month notice period, "I do not think it is indicative of either. I regard the provision as neutral".

Also see Mutuality of Obligation.

Part and Parcel of the Organisation

Contractors must not be 'part and parcel' of the client's business as if they were one of their employees. They should not be on any internal lists of employees or have business cards showing their client's name and, crucially, must not be entitled to any benefits offered to the client's own staff, i.e. bonuses, pensions, and use of facilities such as a gym.

Any clauses that stipulate that a contractor will be subject to performance reviews or disciplinary action (as would be expected of employees) would cause a contract to fail an assessment.

Exclusive Services

When an individual works exclusively for one client, there is a presumption that they are an employee, as it is usual for a self-employed person to work for more than one person. HMRC do not see this as important; their view seems to be that most employees are not restricted to working for one employer. Contractors must have the right, however, to take on additional clients on a concurrent basis.

In Tax Bulletin 28, HMRC do concede that 'long periods working for one client may be typical of employment, but are not conclusive'. The article then goes on to say that 'regularly working for the same client may indicate that there is a single and continuing contract of employment [Nethermore (St Neots) Ltd v Gardiner (1984)]'.

If a contract explicitly states that the supplier is not able to supply their services to other clients this could cause a contract to fail an assessment, although it would again depend on the other positive elements of the contract. It is acceptable for clauses to be included that prevent the contractor from working with the clients direct competitors, or where other conflict of interests exists.

Also see Right of Substitution/Personal Service & Mutuality of Obligation.

Intention of the Two Parties

This is seen as a 'tie breaker' issue - if a contractor's status is unclear after consideration of the other issues surrounding IR35, the intended relationship of the parties can be used to determine the outcome of an enquiry. This test looks to differentiate the type of contract undertaken; a self-employed person works under a 'contract for services' and an employee under a 'contract of service'.

HOW TO COMPLY WITH THE IR35 LEGISLATION?

When it comes to complying with the IR35 legislation, you should consider the following steps:

- **Review each engagement for IR35 status.** This includes assessing both the written terms but also your working practices (the reality of the engagement) against the key factors above.
- **Check that your working practices mirror what is detailed within your contract.** The reality of the engagement holds more weight than the written terms so it is important to ensure your contract is a true reflection of the engagement.
- **Keep a record of your due diligence.** This could include copies of third-party contract reviews, a Confirmation of Arrangements and/or relevant correspondence which may help evidence your position.
- **Pay the relevant tax and national insurance for your status.** Being compliant with IR35 is often confused with being 'outside IR35', but compliance really just means paying the correct tax for your employment status. So if you are operating 'inside IR35' for an engagement, then you will need to make a deemed payment and consider the expenses you are able to claim when inside IR35.
- **Maintain up-to-date assessments** of your engagements - ensuring reassessments throughout the engagement or if there are any material changes.
- **Keep an eye on relevant news** for any changes or updates to how status is determined.

While the IR35 reform will mean that in most cases it will no longer be the contractor's responsibility to determine their IR35 status, contractors should still be focusing on ensuring compliance within their engagements.

It is important to remember that the reform will not apply to any engagements with companies classed as small as per the Companies Act 2006 and contractors are still liable for any services provided prior to April 2021. See above for more information on who is responsible for IR35 compliance.

IR35 COMPLIANT CONTRACTS

An IR35 enquiry from HMRC will always begin with a request for copies of your written contracts relating to the accounting period in question, with proof of why you consider it to be outside of IR35. A robust contract may stop a full-blown investigation in its tracks, so it is essential to ensure compliance in this respect. A variety of status tests, outlined in this guide, are used to assess your contract, with no single test putting you inside or outside the legislation. Both the contract and working practices will require assessment as a whole using all of the status tests to determine your employment status.

The contract does not need to be in writing - an oral or implied contract is legally binding if the parties intend it. The terms of the contract can be collected from the circumstances surrounding the engagement.

It is not only your contract with a recruitment agency which may be assessed; in *Usetech Ltd v Young* the High Court decision made it clear that the "upper level" contract between the agency and the end client was to be considered in deciding the status of the worker, notwithstanding the terms of the agency's contract with the worker's Personal Service Company. Most contractors, however, will never see the upper level contract or have any rights to.

HMRC will look to see if you have taken 'reasonable steps' to ascertain your status and so it is imperative to have each contract reviewed in order to display this.

Having your contract reviewed by an independent third-party expert, will give you a better idea of where your engagement sits in regard to IR35 status. While such a review gives you the IR35 status of that contract, however, in order to find out the overall IR35 status of the engagement you will also need to undertake a review of the working practices of that engagement.

WORKING PRACTICES

The working practices of an engagement is how those services are provided in reality.

The written contract between the contractor and the end client could be perfect in terms of IR35, demonstrating key areas such as substitution, control, non-exclusivity and mutuality of obligation but this will also need to be proven in practice. Although the written contract remains important in determining status, should you be unfortunate enough to be subject to an IR35 enquiry, HMRC will look closely into your working relationship with your client.

In an ideal world, we would like an IR35 friendly contract mirrored by the working relationship with the client.

If you are subject to a status enquiry by HM Revenue & Customs, the Status Inspector will normally want to obtain information from both you and the end client about the practical working arrangements of each engagement. This is known as constructing the "hypothetical contract" between the worker and the client. It is vital therefore that there is a clear understanding between you and the client about the nature of your day-to-day working relationship. This will also apply to situations where there is no written contract.

WHY IS IR35 COMPLIANCE IMPORTANT?

Non-compliance with IR35 could leave you with not only the weighty cost of defending yourself against an enquiry from HMRC but also the potential burden of being saddled with the cost of any unpaid taxes should you be caught by the legislation.

Anyone can be investigated by HMRC, and should you be found to be inside IR35 but have paid tax as an outside IR35 contractor, you will be required to pay back the tax, interest and potential penalties as a result.

You should also bear in mind that an enquiry from HMRC is by no means a walk in the park, not only can these proceedings be extremely stress-inducing but they also have the potential to go on for a long time. The cost of defending yourself from an IR35 enquiry can very swiftly mount up if you don't have an insurance policy.

It is unclear at this stage what compliance will look like after April 2021. Therefore it is important to ensure IR35 compliance remains top on your list of priorities.

TOP 10 TIPS FOR IR35 COMPLIANCE

- 1. Have your engagements assessed for their IR35 status**, by doing so you can evidence compliance with the legislation should your engagements ever come into question from HMRC. By opting for a mixed approach of both a contract and working practices review, you will have a clear picture of the reality of your engagement in terms of IR35 status.
- 2. Educate yourself about what IR35 might mean for your engagements** and keep up to date with the legislation. By using the wealth of online articles available to you, you stand a better chance of ensuring compliance in the way you provide your services by simply knowing what could be classed as inside or outside of IR35.
- 3. Ensure communication within your contractual chain.** By doing so, each party will know what they are accountable for. By keeping track of each other and the determination process it will be easier to make any necessary changes to better IR35 status.
- 4. Take care when checking that your working practices accurately reflect the written contract** you have signed. Not only should you be actively monitoring the way you provide the services to ensure you are acting in a way that is compliant with the terms of your contract, but you should also be collecting evidence to prove this is the case.
- 5.** Make sure you are providing services in a manner that is consistent with working outside of IR35 or **pay the relevant taxes** if not.
- 6. Collect evidence** to show you are treated differently to your client's employees. Examples of this would be a record of any relevant emails or other forms of contact with your client.
- 7. Look for contracts that are outside of IR35** at their very base level, in other words, project-based contracts rather than time-based contracts. Always have a good read of the contract before signing. Another example of this is that you should look to see that you are not individually named within the contract and are only referred to as a business.
- 8. Seek to attain a Confirmation of Arrangements.** Having a CoA signed by your end client greatly increases your chances of successfully defending yourself from an IR35 enquiry. For more information on what a CoA is and how to attain one, see [here](#).
- 9. Show you operate a genuine business** and that you are not part in parcel of your end client's company. Examples of this would be investing in stationery for your business, such as letterhead paper, or simply wearing an ID badge when attending your client's site.
- 10. Have proof that you have taken financial risk** on behalf of your business. Examples of financial risk would be holding relevant business insurances such as Professional Indemnity Insurance or Public Liability Insurance. Both of which we can provide for you [here](#) at JAM.

Support and enquiries

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