

IR35 is a legislation designed to stop workers fraudulently claiming to be contractors for tax benefits. If you're a contractor, you need to make sure that you're IR35 compliant

The Intermediaries Legislation (IR35) was created in 2000 to clampdown on 'disguised employment' via the use of 'personal service companies' – whereby a traditional 'employee' would leave his/her job one day, only to return to work in the same or a similar role shortly afterwards, but working via a limited company structure.

The IR35 rules aim to tax 'disguised employees' who are working through their own companies and using the tax benefits that are available, but are still working in a similar or identical manner to that of other employees.

Importantly, the big picture of how an assignment or contract is carried out in practice would be taken into account, meaning that both the terms of any contracts as well as an individual's working practices must all demonstrate that the person is in business on his/her own account in order to escape IR35.

The Key IR35 factors in determining employment status

Here are the key factors used by HMRC when establishing whether or not an assignment would be deemed to be IR35 caught or not. The first three (control, substitution and mutuality of obligation) are acknowledged by industry experts to be the most important factors.

1. Control & Direction

One of the most important determinants of IR35 status revolves around the extent to which a client controls where, when and how an individual performs his work.

Are you under the direct control of your client?

In most cases where professional services are provided, it is important that a contractor can demonstrate a certain amount of autonomy in the way they undertake a project.

Employees are typically under the direct supervision and control of their employers, however the truly self-employed will have more influence over how they complete the work they have been hired to do.

In the case of IT contractors and consultants, the client is likely to provide a fairly detailed specification outlining the tasks it requires the contractor to complete. However, for IR35 to not be an issue, the contractor should be presented with specific milestones or tasks to achieve, rather than being provided with an open-ended pile of work.

For a contractor to successfully demonstrate that they are not under the direct supervision and control of the client, both the written contract and working practices must show that the client has no influence over how the contractor performs his services, nor the manner in which they are performed.

Control – things to look out for

Contractual pointers towards a classic ‘employment scenario’ include:

- Indicating that the contractor will be supervised by a line manager, or similar company employee.
- Including work start and end times, and even break times in the contract.
- Including any ‘staff’ perks, including provisions for holidays or sickness.
- Any clauses that specify any rights of control or supervision over the contractor.

It is worth noting that any clauses related to control must be mirrored in both the upper tier contract (between agent and client) and the lower tier contract (between contractor and agent).

2. Personal Service / Substitution

The right to provide a substitute in a contractual agreement has long been deemed to be an important factor when demonstrating that a contract assignment fall outside the scope of IR35.

An employee provides his/her personal services to an employer (client), whereas a business would provide its services to a client, rather than the exclusive services of an individual.

As a result, all professionally drawn-up ‘IR35 friendly’ contracts will include a substitution clause.

The right of substitution – important points

- The right to supply a substitute must be a genuine one, otherwise HMRC may conclude that the clause is a ‘sham’. You should be able to show how a substitute could be used in practice, however employment status experts say that simply having the right to provide a substitute is a strong pointer to being outside IR35, even if the right is never exercised.
- An ‘unfettered’ right of substitution means that a client must accept a substitute if the contracted worker is unavailable. This is a strong pointer towards self employment, but rarely available given the nature of IT contracting.

- Clearly, if a substitute has actually been used during the course of an assignment, this is another strong pointer towards self employment.
- Your company should always pay for any costs relating to providing a substitute worker, should the need ever arise. Your company should also provide any training, and make all arrangements for bringing the substitute on site.
- In the real world, end clients will often maintain a veto to accepting a substitute, on reasonable grounds – for example if the substitute does not have sufficient qualifications to perform the job
- If you do not have a right of substitution in place (i.e. your contract is one that requires personal service), this does not automatically mean that you will be caught by IR35, as many other factors are also taken into account.

3. Mutuality of Obligation

A mutuality of obligation exists when an employer expects a worker to undertake work when asked to do so, and the worker expects to be given work on a constant basis. For self employed people, they would expect a client to hire them to undertake a specific task, with no expectation of further work being provided after the initial task expires.

For a contract of service to exist at all, there must be what is known as an ‘irreducible minimum of mutual obligation’ – that the engager is obliged to remunerate the worker, and the worker is obliged to provide his/her skills. As this irreducible minimum could exist in both a contract for services AND a contract of personal service, this is not sufficient to determine the true nature of a contract.

The mutuality of obligation question arises not during the course of the initial contract, but what happens when this contract expires.

It is possible that, by having an IT contract renewed many times, then this could be a pointer towards ‘employment’. In [ESM0543](#), HMRC argues that “where work is regularly offered and accepted over a period of time a continuous contract of employment may be created.”

Things to consider

As a result of the different ways in which HMRC and outside experts interpret case law, employment status specialists tend to focus more on demonstrating that non-mutuality exists in a contractor for services, rather than trying to show that mutuality of obligation does not exist.

Problems may arise if, for example, an end client cannot issue terminate a contract for services immediately, but instead has to provide notice. Again, if a contractor has a ‘rolling’

contract with a client, rather than a fixed length contract, this could also indicate that a mutuality of obligation exists at the end of the initial contract period.

4. Provision of Equipment

Does the individual use equipment provided by the client, or do they use their own?

5. Financial Risk

How much financial risk does the individual undertake in their work? If all the risk lies with the client, then this is an indicator of 'employment' rather than 'self employment'.

6. Basis of Payment

The regularity of payment may have some influence on IR35 status. Self employed people are often paid by the job, rather than a fixed hourly/daily rate.

7. Part & Parcel

To what extent has the individual become part of the organisation?, i.e. do they have access to staff facilities, attend staff meetings, attend staff social events or receive staff benefits?

8. Exclusive Service

Does the individual work for just one client, and have their contracts been renewed many times? The self employed typically work for a number of clients at once.

9. Intention of the Parties

Even if no formal written contract exists, HMRC would want to determine what the true status of the relationship between the parties is – one of employment or self employment.

10. In Business On Your Own Account

Here are some typical pointers to behaving and acting like a 'real business' for IR35 purposes.

- Do you have multiple clients? This is a strong pointer towards self-employment, although each assignment would be judged individually for IR35 purposes.
- Does your company have any income from non-contracting sources (e.g. designing websites in your spare time)?



- Do you have your own business website, and company email address?
- Do you have company stationery, letterheads, a logo, and customised invoices?
- Do you use any of your own equipment for contract purposes?
- Is your company registered for Value Added Tax (VAT)?
- Has your company ever employed anyone else, or used sub-contractors?
- Do you have business liability and professional indemnity insurance in place?
- Has your company invested in training, or improving its marketability in any other way?
- Does your contracting business ever advertise its services, either on its own website, or on freelancer-type portals?
- Do you have dedicated office space in which you have carried out any contract-related work?
- Do you regularly tender for contract work, or apply for contract positions, or have you had multiple renewals for the same client?
- Is your company registered under the Data Protection Act (for dealing with client's data)?

These pointers are the typical characteristics of a working business, and may help show that you are indeed in business on your own account, rather than working in a similar fashion to an 'employee'.

These factors will be used to paint an overall picture of your employment status, and therefore whether an assignment is caught by IR35 or not.