

A guide to IR35

What is IR35?

IR35 is a legislation that was introduced in April 2000 as a way of preventing Limited Companies from taking a dividend where they acted as an employee, thus forcing people who were caught by IR35 to pay PAYE tax and class 1 National Insurance.

How can I stay compliant with IR35?

There are a number of important factors that need to be considered in order to remain IR35 compliant, especially when entering into a contract. These are:

- Working practices
- Right of substitution
- Control
- Provision of equipment
- Financial risk
- Basis of payment
- Exclusive service
- Part of the Organisation
- Factors personal to the contractor
- Mutuality of obligation

Please note that two of the above factors may be sufficient for an individual to be outside of IR35.

Working practices

Not only must the contract be IR35 compliant, but it is also important that the contract is accurate and reflects the true working practices. It is the contractor's responsibility to ensure that this is the case. We always recommend that these details are confirmed with the client and where possible the client signs a working practices document, although this is not always practicable.

Right of substitution

A service company enters into a contract to provide a service rather than personal skills and should be able to provide a substitute or engage helpers to provide the service. An employee would provide his services personally.



For example: Mary Jones is contracted to work at a telecoms organisation, but unfortunately falls ill. Her service company should then be able to offer a substitute to replace her for the remainder of the contract. If there is no substitute, it's a strong indicator of employment and thus within IR35.

In the case of *Chaplin vs. Australian Mutual Provident*, it was held that: *"...the power of unlimited delegation is almost conclusive against the contract being a contract of service, i.e. within IR35"*

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 service company which originally undertook to complete the contract. The right to substitute must not be unreasonably fettered. A right of substitution is only valid if the original service company remains responsible for paying the substitute. The right of substitution is one of the strongest tests of self-employment.

Control

It is essential the service company maintains autonomy over how, when and where the services are provided, both in the contract and genuine working practices. The contractor must not be supervised or controlled by the client as if he/she were an employee. Where a client can move the contractor from job to job due to changing priorities, then there will be a right of control over what is to be done, and this is a strong indicator of employment. The location of the services may be decided by the engagement itself, but it is important that this is agreed upon. It is always beneficial for IR35 compliance if services can be provided from the service company's own offices, even if it is for a relatively small percentage of the time. The contractor should not have set working hours that are dictated by the client; the contractor would be expected to arrange his hours to suit the task and at his/her own convenience.

Provision of equipment

Equipment and other facilities provided by the service company can be important. An employee will have all of the necessary major items of equipment and facilities provided by his/her employer. Contractors will generally provide their own equipment.

Financial risk

If the service company concerned is a genuine business then this is the most relevant test of all. A contractor is responsible for how his/her business is run. Unlike an employee, he/she will provide their own equipment, hire their own helpers, take a financial risk, take responsibility for investment and management and has the opportunity of profiting from sound management in the performance of his/her task. HMRC will look at the risk being taken by the contractor, as it is not usual for an employee to take a financial risk.

Basis of payment

How the service company is paid can be an indicator of IR35 status. Payment in terms of an hourly, weekly or monthly rate is associated with employment, whereas a service company should negotiate a rate for a job, invoice for the work done and bear the expenses and overheads. It should be



remembered that HMRC's own 'Schedule E' Manual states that a self-employed individual can be paid by the hour or day and therefore this test is inconclusive.

Exclusive services

Where a service company works exclusively for one client, there is a presumption that the contractor providing the services is an employee, as it is usual for a service company to work for more than one client. HMRC does not see this as important however; their view seems to be that most employees are not restricted to working for one employer. It has been stated in a previous tax bulletin that HMRC concedes that 'long periods working for one client may be typical of an employee, but are not conclusive'. The article then goes on to say, however, that 'regular working for the same client may indicate that there is a single and continuing contract of employment'.

Part of the organisation

Many contractors often do not realise that they are gradually becoming part and parcel of the client's organisation and this usually happens in cases where a service company has been providing services to the same client for a lengthy period of time. Pointers towards becoming part and parcel of the client's business are:

- **Managing the client's staff or being managed by a member of the client's staff**
- **Attending 'staff' meetings which do not relate to the services being provided**
- **Having to notify the client of absence within a certain amount of time e.g. within the first hour of the first day of absence**
- **Attending company social events such as the Christmas party without paying**
- **Receiving bonus payments relating to performance**
- **Access to free or subsidised meals from the canteen**
- **Use of the staff gym**
- **Being shown on client lists such as telephone lists. If this cannot be avoided, the individual should be clearly identified as a 'contractor'**

Service companies should be aware of these characteristics and ensure that they steer away from them. It is very tempting to accept the offer of a bonus payment; however this could be detrimental when determining IR35 status. A service company can, of course, include performance incentives providing they directly relate to the contractual terms.

Factors personal to the contractor

Other factors such as VAT registration, professional indemnity, employer and public liability insurances, health and safety requirements, licenses, advertising, training, company stationery etc should be taken into account.



Mutuality of obligation

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 it requires. A service company will do the work it has been contracted to do and will complete the project with no expectation of further work. When work is regularly provided and accepted over a period of time, HMRC may take the view that 'employee' status has been created by custom and habit. A long notice period (say exceeding 30 days) is an example of this.

We hope you have found this guide useful. If you would like to talk to us about any further issues you may have regarding IR35, or find out more about any of our services, please contact us on: 0800 25 26 40 and one of our expert advisors will be happy to help.

