Qdos succeed in another IR35 case...

“I just wanted to thank you very much for all the support and help that you gave to me whilst representing my limited company in an IR35 Investigation. To have such a quick response from the HMRC that all of the contracts I had held during that time were outside of IR35 was a massive relief to me. Your guidance and representation meant that I could relax more, knowing that your expertise would guide me through this investigation and I couldn’t be happier with the result. Thank you so much for all your hard work and kindness. The purchase of your IR35 insurance policy is the best insurance I have ever paid for and I can’t recommend you or your policy highly enough. Thanks again - I think it’s finally sinking in!”
What is IR35?

HMRC introduced the ‘Intermediaries Legislation’, that became known as IR35 in the 2000 budget.

The legislation was introduced to combat ‘disguised employees’. This refers to an individual who would be treated as an employee were it not for the fact that they provide their services via their own personal service company and paying less tax in the process.

Contractors working via limited companies are not liable to pay NICs on income taken as dividends, resulting technically in a revenue loss to the Treasury. As a result of this, IR35 exists to enforce proper working practices.

Being ‘caught’ by IR35 can have serious financial consequences. If the Revenue investigates a contract and decide that it is ‘caught’ by IR35, they will calculate a deemed payment treating all income received as salary and demanding that all tax and national insurance contributions on payments originally paid out as dividends.

HMRC can go back up to six years, so even if a contract is finished there is still a risk that it could be subject to an enquiry.

How is IR35 Status Determined?

The interpretation of IR35 is reliant on historic case law and, as a result, some factors surrounding IR35 change over time and certain issues become more prominent following each significant case.

To determine whether an individual is caught by IR35, HMRC will look at both the written contract between the limited company and the agency/end client along with the actual working practices, i.e. the way the work is performed in reality.

In the event of an IR35 enquiry, the working practices will always tend to carry more weight than the written terms themselves. If a compliant contract is in place, it is crucial that the actual working arrangements mirror the written terms.

HMRC will seek clarification of a contractor’s working practices directly from their end client. It is vital that this process is carefully managed.
The Written Contract

If HMRC open an enquiry, they will demand to see copies of all written contracts relating to the period in question. It is important for contractors to understand the legislation, but the best way to determine if a contract is IR35 compliant is to have a professional review.

There are a number of key areas that must be addressed if you are to be considered compliant:

- Personal service/right of substitution
- Control
- Mutuality of obligation
- Provision of equipment
- Financial risk
- Basis of payment
- Exclusive service
- Part and parcel of the organisation
- Intention of the parties
- Business-like trading

Personal service, control and mutuality of obligation are the most important aspects when determining IR35 status.

Other things to look out for in a contract are employment related terms such as overtime, holiday pay and sick pay.

“The written contract is HMRC’s first port of call in an enquiry and an excellent way of starting an IR35 defence on the right footing.”

Personal Service / Right of Substitution

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 help to provide the service. An employee would provide their services personally. The case of Chaplin v Australian Mutual Provident (1978) held that:

“…the power of unlimited delegation is almost conclusive against the contract being a contract of service.”

The right of substitution is one of the strongest tests of self-employment, as shown in the case of Express and Echo Publications vs Tanton (1999) which found that the clause in his contract, “In the event that the contractor is unable or unwilling to perform the services personally he shall arrange at his own expense entirely for another suitable person to perform the services.” was a true reflection of Mr Tanton’s working practices and he actually provided a substitute for a period of 6 months when he was ill.

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.

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

Most agency contracts contain a right of substitution, but it is important that the clause isn’t restrictive and that the right exists in reality.

“The right of substitution is arguably the most important test in determining employment status.”
Control

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

A contractor 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.

Control over how the tasks are completed can be difficult. It is important that contractors retain a reasonable degree of autonomy over their working methods.

In case law for Narich Pty. Limited vs The Commissioner of Pay-roll Tax the comment by Lord Brandon was that control is “the most important, and in most cases, the decisive criterion for determining” it was concluded that, where there is scope for control over how work shall be done and the engager has such a right, then it is clear that it may well be considered to be a decisive factor but the other factors present must also be weighed.

It is also important to consider whether the client has a right to exercise control over the contractor. For IR35 purposes it is important that the client should not have such a right.

Ideally your contract should allow flexibility over the working location, and try to avoid listing specific working hours.

“The end client has no right to exercise control over a contractor’s working practices.”

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 required. A contractor will do the work he is being contracted to do and will finish with no expectation of further work and no obligation to accept further work.

When work is regularly given and accepted over a period of time, HMRC may take the view that employee status has been created by custom and habit. 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 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.

It may 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.
Working Practices

IR35 also revolves around the day to day working life of a contractor and although a compliant contract is important, it will carry little weight in an enquiry if it is not mirrored in the real working relationship between the contractor and end client.

For those who work for the same end client for long periods of time, it is easy to become integrated into the end client’s routine and be treated as an employee. On the whole, the important idea to remember is to not become ‘part and parcel’ of the organisation and avoid anything that confuses the status of an independent contractor with that of an employee.

The same key areas to consider for the written contract should be considered and incorporated into the working practices as well.

“What Can Qdos Do to Help?”

Qdos Contractor has an unrivalled record of defending contractors in IR35 status challenges. In the worst case scenario, Qdos tax specialists can defend you against any HMRC enquiry and dispute, giving contractors the best possible chance of winning.

Our tax consultants have the knowledge and skills, honed by years of successful experience needed to fend off HMRC’s enquiries, by demonstrating that the worker operating through their own company or partnership is genuinely self-employed, rather than a disguised employee of their client.

For complete peace of mind why not consider one of our IR35 services:

• Qdos offer contract review services which can be a fully comprehensive report of a contract and working practices or a basic overview of a contract’s compliance. The latter is offered as a free service with all business and tax insurance products.

• Tax Liability Cover (TLC35) – a fully comprehensive policy covering all legal costs for any HMRC enquiry plus any IR35 tax/NIC liabilities, penalties and interest if caught by the legislation.

• Tax Enquiry Insurance – an essential policy covering all legal costs in the event of any HMRC enquiry.

Qdos also offer advice, guides and free online templates such as model contracts and confirmation of arrangements documents.

If you have any queries regarding IR35 or any of our products please feel free to contact us on 0116 2690999 or email freelancer@qdoscontractor.com
Five Tips to Improve Your IR35 Position

1. Compile evidence that shows why you consider yourself outside IR35. All contractors should have a contract review from a specialist, which could also include a review of your working practices. If this is positive, ensure that you keep a record of it which can be produced in the event of an enquiry.

   It would also be worth creating a simple document that sets out the key reasons that point towards you being a genuine business and not a disguised employee.

2. Exercise your right of substitution. On the face of it this may sound rather implausible, but HMRC will always consider substitution and personal service as the most important factor. If you were able to send a substitute in your place, even for one day, it would have a massive bearing on your status argument.

   In the shadow of the recently introduced Agency Worker Regulations, agencies and end users are keener than ever to ensure that their contractors are seen to be genuinely independent, so suggesting to them that you send a suitable replacement for a day isn’t beyond the realms of possibility.

3. Make sure you are taking a financial risk, because a genuine business would be. Financial risk is an important factor for IR35 compliance because it demonstrates a contractor is in business on their own account, this includes holding business insurances, using your own equipment, correcting faulty work at your own expense and paying for your own training and expenses. You can now buy the full range of business insurance policies (PI, EL and PL) for under £20 a month, so many contractors will consider it a “no-brainer”.

4. Buy or make company stationery. It sounds insignificant, but the little factors that indicate you are a genuine business really do help. In fact, the judge in the ECR Consulting case last year stated the following:

   “ECR is in business on its own account. Elaine produced to the Tribunal copy business cards and company stationery. ECR operates from a dedicated business area at her home. It has company domain and website. ECR advertises its services and is a member of the PCG. It has retained reserves and invested in development and has, over the years, taken on fixed price work for a variety of clients.”

   So having things like business cards, letterheads and a company website can go a long way in an IR35 investigation. Worth it for a small outlay.

5. Put a “confirmation of arrangements” document in place. As we know, an IR35 enquiry will focus on the actual relationship with your end client. The best contract in the world will be rendered worthless if it isn’t backed up with compliant working practices.

   HMRC will seek to quiz your end client about how things work in reality and when they do you’re always on dangerous ground. Who knows what they will say when faced with countless leading questions?

   IR35 specialists have always promoted the use of the confirmation of arrangements. It is a simple document that sets out the true facts of the engagement and should negate the need for HMRC to approach the end client.

   The downside is that many clients are hesitant to sign an extra document, but you can reassure them that it simply serves to confirm your tax position. The fact is that it will benefit all parties if you are subject to an enquiry.