

IR35 is the common term for the 'intermediaries legislation', which came into force in 2000. It is a piece of tax legislation which aims to level the playing field between those working through their own limited company, and those working as a permanent employee.

The legislation intends to differentiate those working as a genuine contractor via their own limited company, and those using a limited company for tax purposes with the working conditions of an employee.

#### Key terms to remember:

**Disguised employee** a limited company contractor using their limited company for tax benefits they are not entitled to.

**Genuine contractor** a limited company contractor operating as a business.

#### How does IR35 work?

IR35 is based on historic case law, meaning that the tests used have been derived from past court rulings. There are a number of tests which are used to determine whether you are operating as a genuine business or not, including whether you take a financial risk or are considered part and parcel with your end client's organisation, however there are three main tests:

**01 Personal Service / Right of Substitution** This test has been considered one of the most important since the case of Chaplin v Australian Mutual Provident (1978). It suggests that as a business, you should not have to provide the contracted services personally and should have "the power of unlimited delegation".

This means that a contract should not be based solely on you providing the work personally. As a business, you should be entitled to provide a substitute worker to undertake all or part of a contract you have secured. Your company would maintain responsibility for the contract, substitute worker, and their payment.

**02 Control** This test encompasses the what, where, when, and most importantly, how you complete the contract, shown in the case of Morren v Swinton and Pendlebury Borough Council (1965).

As a contracted specialist, you should have a reasonable degree of control over your methods of work. Consider the common analogy of a plumber or electrician who has come to fix something in your home; you wouldn't tell them how to fix your boiler as you hired them for their knowledge and capability. You may not find any indicators of this point in your written contract, but more in your working practices so ensure that your client agrees with the fact you are in full control of how you complete your services.

**03 Mutuality of Obligation** This test is that of an expected source of work. As a contracted business, there should not be any expectation of further work, and the client should not be expected to provide it. Judge Howard Nowlan in the 2011 UKFTT case of JLJ Services Ltd v HM Revenue & Customs, suggested that more focus should be placed on non-mutuality of obligation, meaning the ability to walk away from a contract. A clear start and end date to each contract and contract renewal is essential, as without these definitive timescales of your relationship with your end client, the Revenue may take the view that there is a presumed continuation of the contract.

## Other considerations would be...

**Provision of equipment** - A “self-employed” contractor generally provides whatever equipment is needed to do the job. The provision of significant equipment (and/or materials) which are fundamental to the engagement is of particular importance.

For example, where an IT consultant is engaged to undertake a specific piece of work and must work exclusively at home using their own computer equipment that will be a strong pointer to self-employment. But where a worker is provided with office space and computer equipment that points to employment.

The fact a worker might occasionally choose to do some work at home using his or her computer does not change this.



**Financial risk** - An individual who risks his own money by, for example, buying assets needed for the job and bearing their running costs and paying for overheads and large quantities of materials, is almost certainly self-employed.

Financial risk could also take the form of quoting a fixed price for a job, with the consequent risk of bearing the additional costs if the job overruns. However, this will not necessarily mean that the worker is self-employed unless there is a real risk of financial loss.

**Basis of payment** - Employees tend to be paid a fixed wage or salary by the week or month and often qualify for additional payments such as overtime, long-service bonuses or profit share. Independent contractors, on the other hand, tend to be paid a fixed sum for a particular job.

**Opportunity to profit from sound management** - A person whose profit or loss depends on his capacity to reduce overheads and organise his work effectively may well be self-employed. People who are paid by the job will often be in this position.

**Part and parcel of the organisation** - Establishing whether a person becomes “part and parcel” of a client’s organisation can be a useful indicator in some situations. For example, someone taken on to manage a client’s staff will normally be seen as part and parcel of the client’s organisation and is likely to be an employee.

**Compliance without compromise**

**Right of dismissal** - A right to terminate an engagement by giving notice of a specified length is a common feature of employment. It is less common in a contract for services, which usually ends only on completion of the task, or if the terms of the contract are breached.

**Employee benefits** - Employees are often entitled to sick pay, holiday pay, pensions, expenses and so on. However, the absence of those features does not necessarily mean that the worker is self-employed - especially in the case of short-term engagements where such payments would not normally feature.

**Length of engagement** - Long periods working for one engager may be typical of an employment but are not conclusive. It is still necessary to consider all the terms and conditions of each engagement. Regular working for the same engager may indicate that there is a single and continuing contract of employment.

**Intention** - It is the reality of the relationship that matters. It is not enough to call a person "self-employed" if all the terms and conditions of the engagement point towards employment. However, if other factors are neutral the intentions of the parties will then be the deciding factor in employment status.

## Distinction between public and private sector clients

When working in the Public sector, from April 2017, the end hirer will be responsible for assessing the IR35 status of each worker and will also bear the tax risk if the status is incorrect. As a result, workers who are engaged in the Public Sector may find that some assignments are only available on a PAYE basis and they will need to consider challenging the Public-Sector client's IR35 decision in order to be paid gross into their Limited Company.

Workers engaged in the Private Sector will continue to be responsible for their IR35 status and are unlikely to feel any immediate impact on the Public-Sector changes.

Whilst there were no immediate changes to IR35 since moving liability to the end client in the public sector, the Government stated in the November 2017 budget, that they will carefully consult on how to tackle non-compliance with IR35 in the Private Sector and are leaving the door open to rolling out the Public Sector off-payroll working changes, into the Private Sector at a future date. It is therefore worth bearing this in mind for any lengthy or long-term contracts (9-12 months or more) as they may be impacted by any future changes.

## The legal side

Given the list of factors above it is tempting to try and determine a person's employment status by adding up the number of factors pointing towards employment and comparing that result with the number pointing towards self-employment. However, the courts have specifically rejected that approach.

When the detailed facts have been established, the right approach is to stand back and look at the picture as a whole, to see if the overall effect is that of a person in business on his own account or a person working as an employee in somebody else's business. If the evidence is evenly balanced the intention of the parties may then decide the issue.

HM Revenue & Customs has looked at a number of standard agency contracts and has, as expected, suggested that such contracts fail IR35. HM Revenue & Customs will only consider whether specific contracts fail the test and will not give any clearance on standard contracts.

The conclusion of all of the above is that if you sign a standard agency contract you are likely to fail IR35. Even if you get a contract worded differently, HM Revenue & Customs will look at the facts behind the contract.