

IR35 article: Contractual issues

An investigation into the practicalities of contract wording in light of IR35. The sections refer to the Inland Revenue 'Employment Status Guidelines'. This article should be read in conjunction with 'IR35 - Working Practices'.

1. The Element of Control

How much control does the client have over the contractor? If the contract refers to direction, supervision and/or control it is indicative of employment. You may be able to argue that although the contract states this it is not a true reflection of your working practices.

Practical

There are two elements to control:

1. Does the client tell you 'what' to do?
2. Can the client tell you 'how' to do it?

It is generally accepted that the client can tell you what to do but not how to do it. It is necessary for the client to tell the contractor what it is that is required, the definition of the project or what the job entails. The contractor is then left to work out the best way to fulfil the project specifications. If you are an 'expert', this shouldn't pose a problem, after all the reason why you have been given the contract is because of your superior knowledge. The client has hired you for your specialism. In this case there is no element of control. (see also 'the right to substitution') If you are a 'skilled' contractor, then again it shouldn't pose a problem.

What you must ensure is that the contract reflects the fact that the client does not tell you how to do the job. In line with this it is essential that you provide Professional Indemnity cover (see 'Insurances'). For those on help-desk and in support positions it is going to be difficult to prove that the client does not tell you what to do and how to do it. Especially as they probably have the right to move you from one project task to another. In considering control in this environment, there are several queries. These include whether Quality Control, Code Walkthroughs, and/or Standard Code Practice or methodology will be deemed to be control. It is likely that the IR will say it is control but, it should be argued that it is control of the quality and integration of the product not of the person.

2. Mutuality of Obligation

Is the client obliged to give the contractor work and does the contractor have to provide services outside of the contract?

Practical

In practical terms it is very unlikely that there will be any mutuality of obligation. This term simply means that there is no obligation other than to the present contract that you are working under. When that contract finishes there are no more obligations on either side to do anymore work.

3. The Right of Substitution (ROS)

Can the contractor substitute himself with another person or must he fulfil the contract personally?

Skilled Contractor

You may find, if you look at your contract, that there is a clause which allows you to substitute yourself for another equally qualified contractor. The expense of training this person will be the contractor's responsibility, (see Financial Risk). This is an essential clause in the contract for all those who are not deemed to be an expert and is a very good indication of self-employment.

The Expert

The ROS clause is essential in all contracts unless, you are deemed to be an 'expert'. In that case you may want to look at an alternative position. An even better indication of self-employment is when there is no ROS clause or the contract states that you cannot be substituted because the client needs your particular expertise. In this case the ROS is negated by the fact that the client has called you in to tell them what to do and how to do it, (see Element of Control) .

4. Financial Risk

In running a limited company there is an element of financial risk. Does the contractor stand to lose financially if the job is not completed on time? If the 'basis of payment' (see below) is by monthly invoice with no bonuses and the contractor gets paid regularly, this is an indication of a 'salary type payment'. Although traditional invoicing involves risk, if the payment history shows you are paid regularly with out a hitch, it doesn't show much risk. This is a bit contradictory but, it is an argument the IR will probably use. If the contractor buys assets or materials needed for the job, the capital outlay should point towards self-employment.

5. Profit Opportunity

Can the contractor profit from sound management of the company? If the contractor can reduce the companies overheads and profit by organising the work effectively, this is an indication of self-employment. This is interconnected with 'financial risk' and 'basis of payment'.

6. Basis of Payment

There appear to be two methods of payment in this area either the contractor is paid a fixed price for the job, or they invoice on a monthly basis. An employee is paid a fixed salary plus overtime, and other financial benefits. A fixed daily rate or commission work, however, can be an indication of both employment and self-employment. This is a minor pointer.

Practical

The payment for the job should preferably be a fixed sum which is paid when the job is completed. If this is before the end of the contract term the contractor benefits financially and profits from sound management, in the reverse there is a financial risk. This, however, appears not to be the norm. If the payment is on the basis of monthly invoicing you may want to negotiate a completion bonus. Complete on time and you will profit.

7. Right of Dismissal or Termination

In a 'contract for services' which is akin to self-employment, the contract is fixed term and therefore ends on the completion date or on a breach of the contract.

Practical

In most contracts you will find a clause that is entitled 'Notice Period'. This is not a clause you want in your contract. The notice period is indicative of employment. In a contract of service, which is akin to employment, the employer and the employee have the right to give notice, usually about 4 weeks. In a contract for services, the contract should end when the job ends,

8. Grievance Procedures

These are the procedures that the client has to comply with when dealing with an employee.

Practical

In line with this the contractor should not be subject to the clients 'grievance procedures' which are used if you are an employee. If you have done something which the client is not happy about they should just end the contract. They will claim that you are in breach of the contractual conditions and you leave immediately. Likewise if the client has breached any conditions of the contract you, as the contractor, are entitled to end the contract.

9. Employee Benefits

Employees are entitled to sick pay, holiday pay, pensions, etc.

Practical A contractor should not have any employee benefits at all.

10. Length of Engagement

The IR have stated that, in the main, any contract over a month will be considered one of 'disguised employment'. Doing regular work for one client for a substantial period may indicate that there is a single continuing contract of employment. A lengthy engagement needs to be for a specific purpose i.e., a project and not for various different jobs.

Variable Contracts: A contract term will run for the amount of time originally agreed, there may be an extension at the end of it or it may just be terminated. Each extension to the contract with the same client is likely to be treated inclusively with the original contract. So, the IR will take the length of engagement as from the beginning of the original contract to the end of the last extension.

Roll over Contracts: 1 month or longer contracts that roll-over will be treated as one if it is with the same client. Fixed Term: At present the IR is saying anything other 1 month is IR35, this will hopefully be disproved by future case law

Ad Hoc Contracts: In a recent case it was held that a series of 'ad hoc' contracts did not amount to employment. An 'ad hoc' contract is where there is no mutuality of obligation to provide work or services. The company simply calls you and you agree to provide the services for that day or week. The term of each contract is short but, collectively they can run for years. This is a somewhat unique position and it is unlikely to be relevant in IR35

11. Intention

If the decision as to whether the contractor is employed or self-employed, is in the balance, it is the intention of the parties which will be the deciding factor. In most cases the contractor and client will intend that there is no contract of employment.

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