

Contractors' clients can avoid litigation in IR35 cases like Dragonfly

Clients who land their contractors with huge tax bills by giving HMRC evidence that implies the contracts were within [IR35](#) are likely to be free of any resulting threat of legal action by their contractors, according to employment law expert [David Royden](#) of [Laytons Solicitors](#).

Following the recent [Dragonfly Consulting ruling](#), the contractor Jonathan Bessell was left with a bill for £99,000 following evidence supplied by his client that indicated his contract was inside IR35.

This was only one of many cases where the contractor has been caught within IR35 and forced to pay substantial sums in tax, National Insurance Contributions (NICs) and penalties to HMRC as a result of evidence given by clients.

However, according to Royden, the contractor can do nothing as technically the client is not in breach of contract: "All the client company is doing during an investigation or subsequent case is advising on the reality of the contract."

Notional contract

"Any contract where the contractor is suspected to be within IR35 will be judged on the notional contract," continues Royden, "that is to say, the reality of the situation rather than the express contract terms."

And if the client does not consider the contractor to have the unfettered [right to substitute](#) another contractor to do their work, even if the written contract itself states there is that right, then the reality of the situation will apply.

The client is not breaching the terms of the contract with their contractor if they are simply reporting what they believe to be the true state of affairs, and the contractor has no legal recourse to what the client says.

Contract variations are common

"Having variations between the express or written terms of a contract and the reality of how the contract is delivered is quite common," says Royden, "particularly in the broader area of employment law, where agency workers might be claiming rights as an employee because the reality of their relationship with the client was one of employment."

Variations occur in service contracts all the time, and these may be agreed verbally, or by a side letter, or by custom and practice. However, for the variation to be confirmed there must be a tangible consideration provided by one party receiving the services to the other providing the services, although this does not have to be monetary.

Creating a pattern of substitution

Understanding clearly what a [right of substitution](#) means is important, as Royden explains: "A right of substitution is expressed to be 'substituting someone else to do what the contractor should do within the contract'." So his advice is clear: "Contractors must ensure they have the right to substitution in their contracts and that on occasion this right is actually exercised."

"The purpose of exercising the right is to establish a pattern to demonstrate, in reality, that the right of substitution is not just an express contractual term but also forms part of the notional contract with the client."

Of course, many clients may still be uncomfortable with the idea of a contractor providing a substitute, but it is clear that the contractor sector needs to educate the client community about how the industry is changing.

In the current scenario, contractors effectively bear all the risk in their contracts with clients. They have no employment rights, nor do they expect them, but they do bear the entire risk should an [HMRC investigation](#) prove successful, allowing the client to walk away with no liabilities.

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David Royden, Laytons Solicitors



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