

Contracts alone won't protect contractors from IR35

A contract between a contractor and a client is not necessarily a defence against a determined [HMRC IR35 investigation](#), as highlighted by the recent case lost by the [Alternative Book Company](#).

In that case, although the contracts stated that the contractor, Keith Shepherd, had the right to send a substitute, the client refuted this. The court found for HMRC, rejecting Shepherd's appeal on the grounds that his notional contract with the client was very different from the actual contract. Therefore, Shepherd was working within [IR35](#).

Notional Contract is Key

According to former tax inspector Carl Whittaker from [Qdos Consulting](#), it is the "notional contract", or the real relationship between the contractor and client that is key. "A contractor may have a contract with all the right clauses regarding [control](#), [right of substitution](#) and [mutuality of obligation](#)," explains Whittaker, "but if the client thinks differently, and is prepared to tell HMRC investigators so, then the contractor could be in trouble."

Qdos has successfully defended over 1,000 contractors against HMRC investigations. The first step, says Whittaker, is to get a signed [Confirmation of Arrangements](#) from the client: "When a client has put their name and signature on a document confirming the actual working practices, they can be very reluctant to change this statement at a later date when being questioned by tax inspectors."

"So, when taking on a case, our first step is to ensure the contractor approaches the client with a draft for them both to sign. It's also vital that the signatory on behalf of the client is an employee, not another contractor."

Investigations can take years and cost thousands

Ideally, contractors should obtain a signed Confirmation of Arrangements at the start of every contract. In fact, if a contractor wants to take out a tax liability cover, they will be required to do this as part of the application procedure. "An investigation can take years and, if it goes as far as Special Commissioners and appeals, can cost tens of thousands of pounds in defence costs. And this doesn't include back taxes, National Insurance Contributions (NICs) and penalties. And for that reason contractors would be wise to consider an [IR35 tax liability cover policy](#) too, which, in addition to paying the costs associated with running a defence, would also pay out if the contractor lost and owed money to the taxman."

You're guilty until you can prove otherwise

In the UK, tax law says that you are guilty until you can prove your innocence. If you do not mount a defence, you are assumed to be guilty and automatically have to pay any outstanding taxes, NICs and penalties.

"Contractors subject to tax investigations have no protection under the law, as someone accused of a criminal offence would have. HMRC's investigators can delve into every aspect of your life and use any evidence against you," explains Whittaker. "And because the investigations can take so much time, the stress for the contractor can be incredible, in some cases not knowing whether they will be solvent or have a roof over their head in the near future."

Notional contracts can work for you

Although a poorly worded contract is like a red rag to a bull for your average HMRC inspector, the notional contract has saved many of Qdos' clients from falling within IR35.

"Ideally, contractors should have an appropriate contract in place, and as part of the application process for our insurance products, we ask contractors to check their contracts and seek a Confirmation of Arrangements from their client," continues Whittaker, "but we have successfully defended clients whose actual contracts were only just contracts for services but whose notional contracts put them outside of IR35."

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Carl Whittaker, Qdos Consulting

"We did have one client whose contract did not explicitly include a substitution clause. However when we investigated and talked to the client, we found out that the contractor had actually used a substitute, and that fact put the contractor right outside of IR35."

Agencies

Most contractors have no idea of the exact contractual relationship between their agency and client. Once an investigation starts, Qdos advises contractors to obtain a copy of the contract from their agency. HMRC will certainly want to see the agency-client contract and it has been known for there to be discrepancies.

This, according to Whittaker, is another reason why the notional contract is so important. "If the upper level contract between the

agency and the client differs from the lower level contract between the contractor and the agency, for example by not including a right of substitution, the notional contract could work to the contractor's advantage."

Whittaker concludes by saying: "Fighting inspections and rulings by HMRC is not for the uninitiated. Most cash businesses, even small firms like corner shops, have tax investigation insurance that can remove some of the stress associated with the process. Contractors can act now to protect themselves by investing in a good [IR35 insurance](#) policy, before an inspection starts."

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