

## IR35 contract problems: Top 10 reasons a contractor's contract will fail IR35

Contractors need to take their contract negotiations seriously – very seriously – to avoid the **IR35** traps that could not only make their contracts fail IR35 tests, but also **cost them an awful lot of money**. And the loss of cash can be just the start of IR35 nightmares, because IR35 problems can lead to a great deal of stress and intrusion.

In fact, a contractor subject to an **IR35 investigation by HMRC** will find that every aspect of their business and working life, and a sizeable chunk of their private life as well, is put under a microscope. HMRC will be looking for any evidence suggesting the contractor is not **in business in their own right**, but is instead a **disguised employee** of their end-user client. And usually the first place HMRC will look for 'IR35 fails' will be the contract.

But there are a number of classic reasons making a contract fail IR35, which contractors can take steps to avoid. Here are the main ones:

### Reason 1: Background/previous ruling

If a client organisation has previously been found by HMRC to have used 'disguised employees', then the taxman can insist that all future contractors be treated as employees. In such cases, all the client's contractors are likely to be treated automatically as working inside of IR35.

### Reason 2: Contract

The contract has not been written specifically for the contractor's particular engagement, is clearly cribbed from another source, or has been cobbled together on a 'DIY' basis, and is riddled with errors and inconsistencies. HMRC can spot these at ten paces.

### Reason 3: Control

A key test of employment, and therefore IR35 status, is **whether the contractor is controlled by the client**. If the contract includes a clause that paints a picture of control, and may even include a statement confirming the contractor is under the direction and control of the client, there is a greater chance that the contract will fail IR35 tests and be found to be inside IR35.

### Reason 4: Substitution

Another key test of employment says that if a contractor is not allowed to send a replacement, or substitute, to take their place to deliver the contract, this probably means that the contractor is really an employee. Some contracts include a clause specifically disallowing a **right of substitution**, potentially putting the contract squarely inside of IR35.

### Reason 5: Mutuality of Obligation (or 'MOO')

A test of employment that employment law experts consider has lesser weighting than control or substitution, but is nonetheless still important is **mutuality of obligation**, or MOO. A typical MOO scenario is where the contract implies that the contractor is entitled to ongoing work, eg through a clause referring to automatic renewals, and the contract also says the contractor has to take any work handed to them by the client. This indicates that, like any other employee, the client is obliged to give the contractor work and the contractor is obliged to do the work – an IR35 fail.

### Reason 6: Financial Risk

If the contract states a set number of hours per week to be worked with an hourly rate and the contractor does not have a defined deliverable within a specified period, or a clause stating that mistakes must be rectified in the contractor's time, then the contractor can be deemed not to be taking a financial or business risk. This implies the contractor is not in business in their own right and is probably a disguised employee. Therefore, this would be seen as an IR35 failure.

### Reason 7: Equipment

A contractual requirement for the contractor to use only the client's equipment onsite could be interpreted as a lack of financial and business risk, particularly if the contractor has not bought any equipment of their own through their **contractor limited company**. This can be a reason for a contract to fail this IR35 test, but only usually in conjunction with other factors (see Reason 10, below).

### Reason 8: Part and Parcel

If the contract specifies things like the contractor being allocated their own office, or is integral to the management chain of command with a manager and possibly staff of their own, this will set IR35 alarm bells ringing at HMRC. This is a particularly easy IR35 test to fail, as it can include things that seem perfectly sensible, like the contractor having access to employees' facilities – things like the right to eat in the staff canteen or having a staff pass to avoid having to sign in every day. If the contractor has business cards in the client's name, appears on telephone directories or in organisation charts, then HMRC can judge the contractor to have become **'part and parcel'** of the client's organisation – an IR35 fail

## Reason 9: Intention of the parties

A classic mistake, found particularly in DIY contracts, is for the contract to omit completely that the intention of the contract is to form an agreement between a self-employed contractor and a client, and not an employee and employer. Leaving out the intention of the parties will contribute to making the contract fail IR35. HMRC will use a poorly constructed contract that includes these classic reasons to help its case in proving that a contractor is really a disguised employee and to put a contract inside IR35.

Contractors genuinely in business in their own right will be able to argue their position as being outside of IR35 and provide evidence to that effect. However, it should also be noted that the contract must be a genuine reflection of working practices. That's because, whatever the contract says, if the relationship between the contractor and client is clearly an employee-employer one, then in some situations the actual relationship will be judged to over-ride the contract.

## Reason 10: Body of evidence

There is rarely any single reason for a contractor's contract to be found inside of IR35; rather there tends to be a holistic body of evidence that a tax inspector will gather to arrive at their decision. So a contract where two or more of the first nine reasons look like they might possibly fail IR35 tests is more likely to be investigated by an inspector than one where there is little or no doubt that the first nine reasons 'pass' IR35 tests.

Seeking professional advice when creating, reviewing or [renewing a contract](#) can prevent a contractor from making common IR35 mistakes. And should HMRC deem that a contract is inside IR35, it is strongly recommended that contractors seek expert help to guide them through an HMRC investigation.

For an initial indicator of IR35 status contractors can freely use the online [IR35 test](#) on ContractorCalculator.

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