

An IR35 replacement will be a challenge

Contractors should take heart from the indication by government that an [IR35 review](#) is a priority. But for those at the Office of Tax Simplification ([OTS](#)) tasked with the review and devising a replacement, finding a solution that pleases all will be a challenge.

Just how difficult that challenge will be is highlighted by the requirements of the initial report the OTS must provide to the Chancellor. That report must:

- o Demonstrate that [IR35](#) is complex and leaves many contractors uncertain of their exact status
- o Consider alternatives that will be simpler and more certain, but will also ensure disguised employees are still taxed fairly
- o Ensure that the scope for tax avoidance is factored in when creating any alternatives to IR35.

The government has also stated that it is interested in the wider implications of employment status and tests used for its determination, and how that could impact on larger business. This might mean the OTS returning to one of the initial aims of IR35, which was to provide employment rights for disguised employees.

Employment status is not black and white - it's shades of grey

ContractorCalculator CEO Dave Chaplin, himself a former IT contractor in the City of London, is convinced that whatever solution is created, some contractors will be disadvantaged, simply because of the complexity of potential flexible working relationships.

"The practical issue is that there is superficially very little to differentiate a genuine contractor with a single concurrent client and a 'perm-tractor' who really should be an employee," says Chaplin. "As part of our research with IR35 and employment law experts [Qdos Consulting](#) to create an effective [online tool to determine IR35 status](#), we've identified at least seven discrete scenarios."

Chaplin has assigned 'personalities' to each of the categories to help understand what differentiates them:

1. Bob, a perm-tractor, same client for 15 years with 30 days notice each way, training paid for by the client who also determines what Bob works on; he attends all staff social events and most colleagues don't even know he's a contractor
2. Steve, a genuine contractor in business on a 12-month contract, with no notice, working on a specific project, can refuse other work. He has technical skills the client lacks, he paid for the training to acquire these, and is liable for errors six months after the contract ends
3. Sue is a 'vulnerable worker' earning £12 an hour with no specialist skills and hired originally as a temp, but only on condition she formed a limited company. She's been with the client for 18 months and would prefer to be an employee
4. Sally is a chartered accountant who has been employed as financial director for 10 years before the top rate of tax was introduced, when she resigned on a Friday, returning on Monday to the same role as a limited company contractor, paying much less tax
5. Kevin was employed as an engineer at the same company for 30 years. On retirement, his ex-employer offered consultancy work at £1,000 a day; it's ad hoc and sometimes he is travelling and can't work. He has another occasional client
6. Deepak was a brand manager made redundant when his employer could not afford him full time. But he was invited to come back as a contractor for three days a week, performing the same duties in a reduced capacity
7. Michelle describes herself as a freelance translator. She has around 15 concurrent clients that keep her working full time. Each is charged differently according to the services performed, which could be a few hours or weeks depending on the project.

"When you look at their individual circumstances, it's likely that in reality Bob, Sue, Sally and Paul are disguised employees," continues Chaplin. "But Steve, Kevin and Michelle are genuinely in business. Any new legislation will have to recognise these distinctions."

What's in a name?

According to Chaplin, there is also a major challenge over how flexible workers are labelled by legislators/regulators, made even more complicated by the fact that these workers often call themselves by titles that conflict with official terminology. This further compounds the potential for confusion.

Temps, or temporary workers, tend to work on short-term assignments and are told what to do, often providing cover for absence. Contractors tend to have a single client and work on a specific project. Freelancers tend to have multiple clients, performing multiple tasks. Consultants have several concurrent clients and tell the client how to do things, rather than perform the work themselves.

“ The practical issue is that there is superficially very little to differentiate a genuine contractor with a single concurrent client and a

Temps mostly fall into the 'employed' bracket, but contractors, freelancers and consultants are all genuinely in business, and ought to be taxed accordingly and so excluded from IR35 and its successor.

'perm-tractor' who really should be an employee ”
Dave Chaplin,
ContractorCalculator

Potential solutions

Canada's tax agency, the Canada Revenue Agency, applies a [four-point test](#) that asks about control, ownership of tools, financial risk and 'part and parcel' issues. In Australia, contractors are asked to pass the [Personal Services Income \(PSI\) tests](#). These are based on a requirement that contractors are paid on project completion, provide their own tools, and rectify defects at their own expense. If any of these tests are failed, contractors then face a battery of further questions.

Other solutions that have been mooted include:

- o The 80% rule, where if the income from a single client in a given period, such as the tax or financial year, exceeds 80% then the contractor is deemed to be employed and taxed accordingly
- o The 'previous client rule', where if 80% of income from a single client, which is the same organisation as the previous employer, then the contractor is deemed to be employed and taxed accordingly
- o The 'project rule', where contracts are based on discrete, specific projects with deliverables and end-dates: open-ended contracts leave the contractor deemed to be a disguised employed and taxed accordingly.

Chaplin concludes: "The Office of Tax Simplification faces a potentially insurmountable challenge to find a replacement for IR35 that satisfies each segment of the flexible workforce, as well as end-user clients. We can only hope that it is not the [one-person contractor limited company](#), the trading vehicle used by most genuine contractors, that is singled out for special treatment and differentiated from other small businesses."



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Dave Chaplin is a former IT contractor in the City of London, and is founder and CEO of ContractorCalculator, and author of the Contractors' Handbook.

Started in 1999, ContractorCalculator (this site) is the leading independent website for the UK contracting industry – most of whom are highly skilled knowledge workers.

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