

IR35 and substitution: substituting twice a year could save contractors thousands

An increasing body of evidence suggests that a true unfettered [right of substitution](#), when exercised twice a year, is the determining factor placing contractors outside of [IR35](#).

This is crucial, because with a contract that puts the contractor inside IR35, the typical drop in net income after taxes is approximately 10% to 17%. At the same time, by failing to prove that a previous contract was outside IR35, contractors can find themselves paying retrospective income tax, National Insurance Contributions (NICs) and penalties amounting to many tens, possibly even hundreds, of thousands of pounds.

Andrew Vessey, from contractors' affairs specialists [Qdos Consulting](#), explains: "A genuine right of substitution, especially if it is exercised, will knock all other status factors into touch. This has been alluded to by judges in recent employment status cases."

The essence of the [IR35 legislation](#) has always been that, if it were not for intermediaries such as a recruitment agency or a contractor's [limited company](#), the true relationship between the contractor and the end-user client would be one of employment, that is a 'contract of service'.

Personal service not a requirement

But a 'contract of service' requires the worker, or the employee, to perform the task personally for their employer; an employee can't send a replacement. And this is accepted as a defining test of employment.

"Where a worker engages another worker to perform all or part of the services on their behalf then they are sub-contracting the work," continues Vessey. "Paying helpers during the course of a contract helps to argue that the personal service of the contractor is not a requirement of the end client."

And if the contractor's services are not required personally by the end-user client, and in fact are not delivered during the course of the contract because a substitute has been used, then they cannot possibly be employed in a contract of service and are therefore not subject to the requirements of IR35.

But the client must be aware of the substitution

The temptation for many contractors must be to create a small team who work on similar projects and simply cross-invoice each other a couple of times a year to appear to be subcontracting to a substitute.

According to Amie Norton of Qdos Consulting, this won't wash with HMRC or a court: "Unless the work is very much back-end administration, the client must be aware of the substitution, otherwise it is not a genuine substitution."

The issue is the provision of a personal service by an employee. If the client still thinks they are receiving the services of the contractor only, then if the notional contract or the real situation is examined – as it will be during an [HMRC investigation](#) and possibly later in court – then according to the client no substitution has taken place.

If the client is aware that they are not receiving the personal services of the contractor for the period of time when the substitution is exercised, then they must also accept they are not receiving the exclusive personal services of the contract, which therefore does not pass the test of being an employee and puts the contractor outside IR35.

Total responsibility lies with the contractor

Norton stresses that when the substitution clause is exercised, the contractor is still completely responsible for every aspect of the contract with the end-user client, and must be seen to be so.

"The contractor must remain responsible for paying the substitute both when they are working directly on the contract and during any training and handover periods," says Norton.

"Under the terms of the substitution, the contractor is also responsible for maintaining quality control and is ultimately responsible for the successful conclusion of the contract."

A substitute qualifies as genuine when substituting for all or part of the work that the client is expecting to be completed. However,

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Amie Norton - Qdos Consulting

the contractor does not have to hand over all the work to the substitute. It is possible for the substitute to work on a small part of the overall contract, for example some low grade repetitive tasks, and still be a genuine substitute, working alongside the main contractor.

Although for many contractors it may prove difficult winning over clients to the concept of the right of substitution, and may potentially eat into their own income, the alternative of being caught by IR35 or undergoing years of investigations, appeals and court cases, is much worse and almost certainly more costly.


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