

Contractor Doctor: If my client lets me substitute purely for IR35, would it count?



Note that the business entity tests have been abolished, effective from April 2015. HMRC will continue to honour its commitment not to investigate for three years contractors who had previously taken the tests and secured a low risk score.

Dear Contractor Doctor,

Having seen [HMRC's new IR35 processes](#), it appears that the silver bullet to blow away any HMRC inspection is still proving that a [substitution](#) took place. But during my ten-year career as an IT contractor, I've never been away from the contract long enough to justify having to send in a substitute.

However, with HMRC increasing its compliance activity, I'm considering whether I should actually send a substitute. It would be fairly easy to pick out a piece of work that could be done in isolation in a couple of days, and assign it to a contracting friend. My current client would question this, so I'd explain the [IR35](#) reasons behind it, and they would probably go along with my idea to help me out.

If my client lets me substitute purely for IR35, would it count?

Thanks

Dave

Contractor Doctor says:

"There is nothing to suggest that the underlying reason for a substitution should have an impact on its validity," explains [Roger Sinclair](#) of contractor legal specialist Egos. "But I'd still recommend documenting a valid business (ie non-tax related) reason for sending a substitute, just in case – even if the reason is simply to take a few days off!"

He adds that if contractors who have legitimately substituted using the correct procedures, then under [HMRC's business entity tests](#), they should expect to be in a position to enjoy three years contracting without having to worry about [IR35](#), assuming their circumstances don't change.

It should be noted, however, that the business entity tests were only introduced in May 2012, and HMRC has said they will be subject to a 12-month 'test and learn' phase. So the tests, and the weightings given to individual factors – such as substitution – are subject to change.

Attention to detail is important when substituting

According to Sinclair, attention to detail when substituting is very important: "If a contractor does undergo an [IR35 review by HMRC](#), or has to contest a settlement in a tax tribunal, HMRC will be looking for opportunities to claim a substitution was flawed.

"A valid substitution requires sending someone else to do part of what a contractor's [limited company](#) is contracted to do, and doing so transparently, ie so that the client is aware of the substitution," continues Sinclair.

"The contractor must source the substitute, make the necessary arrangements, such as agreeing contracts and providing any necessary training, and pay the substitute directly."

HMRC's business entity tests deliver a three-year 'get out of jail free' card

Assuming the contractor has an adequate audit trail, so they could provide HMRC with evidence of each aspect of the substitution, and they substitute once every two years, Sinclair believes this effectively delivers any contractor who qualifies with three years free from IR35 worries.

Sinclair notes: "In its [guidance published in May 2012](#) that introduced and explains the business entity tests, HMRC makes a categorical statement that contractors who can show that they are low risk according to the business entity tests will have any IR35 review immediately dropped and will not be reviewed for a further three years, assuming their circumstances do not change."

The business entity tests in their current form score any substitution within the previous 24 months at 20 points, which places a contractor able to prove a legitimate substitution has taken place in the last two years straight into the low risk category.

Contractors should focus on securing and maintaining low-risk status

In Sinclair's view, contractors should seize the opportunity to use the tests legitimately to their own advantage: "HMRC would get into difficulties if it went on to do something contrary to what it has declared in its guidance, where it says it will close an IR35 review and it will not check again for three years."

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Roger Sinclair, Egos

Contractors are under no obligation to take the tests, nor are they obliged to reveal the results to anyone. But focusing on how to improve their score could potentially lead to periods of much greater IR35 certainty and stress-free contracting.

Sinclair concludes: "To take advantage of the opportunities offered by the business entity tests, contractors in Dave's situation should substitute at least once every two years, document a sensible reason why the substitution was required, and ensure they can produce detailed evidence if asked to by HMRC."

Good luck with your contracting!

Contractor Doctor

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