IR35 Explained: ‘Contract of service’ and ‘contract for services’

An understanding of the types of contracts between clients, agencies and contractors and employees is vital for a contractor to be able to determine whether they are working inside or outside of IR35.

However, the debate over contracts of service and contracts for service has a long history in employment law, as has the employment status of agency workers long before the contracting sector took off and IR35 was introduced. This guide will explain the IR35 issues related to these types of contracts and how they affect you the contractor.

Please explain the differences between a ‘contract of services’ and a ‘contract for services’ – does it change my IR35 status?

An easy way to explain the difference for IR35 purposes is:

An employee-employer contract is a contract of service
A contractor-client contract is a contract for services

In each of these types of contract, both parties have specific rights and responsibilities, which differ according to the type of contract in place.

Contractors should be aware of their rights and responsibilities when they have a contract for services between their limited company or contractor umbrella company and their agency or end-user client as it will affect their IR35 status.

**Employer-employee contract of service**

Permanent employees have a contract of service with their employer. By definition, if a worker has a contract of service with an organisation, they are an employee for IR35 purposes.

The key rights and responsibilities of employee status under a contract of service are:

- The worker is controlled by their employer – they must perform the tasks they are instructed to, by a line manager according to their job description
- The worker is expected to work at a specific place during specific hours on specific days (even flexi-time has core hours)
- The worker must present themselves for work and cannot send someone else as a substitute
- Employees have statutory rights to holiday pay, sick pay, maternity and paternity rights and redundancy payments
- Employees have statutory rights regarding how they can be asked to leave their employment
- Employees enjoy a range of additional benefits, which can vary according to the employer, but might include company cars, private health insurance, staff canteens, health clubs and gyms and so on
- Employees are not personally liable for any errors they make when completing work for their employer, nor are they expected to make good in their own time.

There is also a relationship between an employee and employer called ‘mutuality of obligation’, often referred to in shorthand as ‘MOO’. Mutuality of obligation is one of the key tests of employment status and whether a contract is inside or outside of IR35.

Mutuality of obligation means that an employer is obliged to provide work for an employee, and the employee is obliged to complete the work. Within the scope of their job description, employees have to complete the work that ‘comes down the pipe’, which is one of their fundamental distinctions from a contractor.

If the employee fails to fulfil their obligations, the employer can take action that may ultimately result in the employee’s dismissal. Similarly, if the employer does not fulfil their obligation to the employee, the employee can take action that might result in an industrial tribunal.

If you are investigated by HMRC they will consider all these issues when determining your IR35 status and they will ask you explain yourself if they find discrepancies.

**How does a ‘contractor-client contract for services’ affect my IR35 status?**

Contractors have a contract for services with their client or agency. Or to be more precise, the contractor’s limited company or umbrella company has a contract of service with the client or agency.
A contract for services is a strictly business to business contract between two firms on a buyer and supplier basis. The client, or agency, is a buyer and the contractor’s limited company or umbrella company is the supplier. There is no question of any employment relationship.

Contractor’s companies that enter into a contract for services with another organisation (including public sector organisations or not-for-profit companies) have clear rights and obligations.

The key rights, obligations and responsibilities that a contractor’s limited company or umbrella company have under a contract for services include:

A requirement to supply services to the client according to the contract schedule’s specification
A requirement to complete the project, and any milestones, according to the contract schedule
A requirement to provide services to the standard required by the client as agreed in the contract
An obligation to make right any errors or defective work, without additional remuneration

Liability for any errors or defects in work completed for clients, and this may expand to personal liability (assuming the contractor is a director) for worst-case scenarios, such as corporate manslaughter

The right to be paid the rate agreed in the contract, assuming the services have been provided according to the contract’s requirements
The right to be paid according to the terms agreed, such as within 7 days, or 30 days depending on the terms agreed in the contract
The right to provide a substitute to complete the work specified in the contract

Often the contractor is required to abide by any health and safety and security arrangements when working on the client’s site

The client is obliged to provide a safe working environment for the contractor.

As directors of their own limited companies, contractors also have a range of duties, responsibilities and potential liabilities under company law, which employees do not have.

If either party fails to fulfil their obligations under the terms of the contract, they are in breach of contract and can take legal action to remedy the situation.

In effect, the relationship between a contractor’s limited company or umbrella company and the client or agency is no different from a major international corporation’s relationship with its suppliers.

Contractors who are aware of the full range of issues surrounding contracts of service and contracts for service are in a much better position to judge whether their employment status is affected by IR35, and can seek professional assistance accordingly.

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