

IR35 avoidance: Staying outside IR35 if you go contracting for your former employer

Contractors returning to work for a former employer, or being asked to return immediately on a contract basis after redundancy, face a very real threat of being found inside of **IR35**, says Kate Cottrell of contractor IR35 consultancy **Bauer & Cottrell**.

"It is possible for a contractor to remain outside IR35 when contracting for a former employer, but they have to work that much harder to prove they are not a **disguised employee**," she says. "Not only does the contractor have to avoid falling foul of the standard tests of employment, but he or she also has to clearly identify and demonstrate how the relationship and working practices have changed since changing status from employee to contractor."

Standard tests of employment

According to Cottrell, the standard tests of employment apply to determine whether the contractor is in fact a disguised employee: "The first test would be to see if the contractor is **controlled** by the client. This could be tricky if the client has been used to issuing instructions and managing their new contractor when they were an employee," she says. "What's to stop the client from telling the contractor what to do, how and when, just because they have a different contract?"

The next key test is **right of substitution**, which in Cottrell's experience is often where the truth about the relationship emerges. "If the client is asked whether the contractor can send a substitute the answer is frequently no, whatever the contract may say. The client's view is typically, 'we hired Jane Smith precisely because she's worked for us for ten years as an employee, so it's Jane we want doing the job and not someone else'."

Take steps to clarify the relationship

Over the years, Cottrell has seen many former employees contracting with previous employers, particularly when economic downturns make this a mutually beneficial arrangement. In such cases, she is often asked to review contracts and the working practices to create a bespoke confirmation of arrangements. But what is involved?

Cottrell explains: "I will prepare an analysis of the contract of employment and working practices when the contractor was employed, and also outline the new working practices and **contract for services** for the new contract. I'll look at the relationship then, the relationship now and ask what's the difference, identifying what has changed and where this leaves the contractor regarding IR35."

The **confirmation of arrangements** detailing how the contractor performs their duties is essential. "It's a bit more than the client simply telling the contractor they can't use the staff gym; the client has to understand the relationship is different and act accordingly," adds Cottrell.

This also means the new contractor must actively avoid any old roles that place them in an employee's shoes, like being a fire marshal or first aider. They should sign in every morning, use visitor parking spaces and make sure they are no longer part of company organisational charts and telephone directories unless clearly identified as a contractor. They should even steer clear of organised staff social events, like Christmas parties.

'In business' tests

"When a worker returns to their former employer as a contractor, the client is looking for all the benefits of hiring a contractor, but with the added benefit of knowing the ex-employee knows how to do the job," says Cottrell. "The contractor wants the flexibility and higher take-home pay of being self-employed, but with the comfort of a regular income. However, the contractor must demonstrate that they are genuinely in business."

She warns that by continuing to work for their ex-employer immediately after their contract of employment has been terminated, contractors have no time to establish themselves in the eyes of the taxman as being **in business on their own account**.

"If the contractor absolutely has to start on the Monday after leaving on the Friday, then the first contract they work on should ideally be a project with clearly defined outcomes, preferably on a fixed-price basis, rather than an hourly or daily rate," says Cottrell. "Staged payments on achieving significant project milestones should be written into the contract, leaving little doubt that the ex-employee is now taking a significant business risk."

Run the contracting business like a business

HMRC would also expect to see a number of other factors indicating the contractor is genuinely in business. These would typically include: **registering a limited company**, setting up a business bank account, buying business insurance and equipment for a home office, incurring marketing expenses for a website, business cards and some advertising.

"These will all work in favour of the contractor being seen as in business, and not a disguised employee," says Cottrell. "Running concurrent clients would also help, but IR35 is evaluated on a contract by contract basis, and there is no 'silver bullet' that guarantees a contract on its own is outside IR35."

Understand and respect new arrangement

“Technically, there is no legal impediment to prevent a worker starting their day as an employee and becoming a self-employed contractor by the afternoon,” says Cottrell. “But the biggest barrier is often the former employer, now client, who has to understand the rules have changed.”

The new contractor must be confident that not only has their former employer understood the legal and tax implications of the new arrangement, but is also prepared to treat the contractor as a business-to-business supplier. The contractor should also be confident that the former employer would be able to accurately explain and defend the new relationship to an HMRC inspector, and potentially to a tribunal or even High Court judge.

And Cottrell warns that there are risks on both sides, as the client could be entering a minefield of employment legislation if hiring a worker turned contractor who they’ve just made redundant. “Clearly there could be questions put to the employer/client about the legitimacy of their redundancy process.

“So, it is certainly possible for a worker to switch from employee to contractor for the same employer/client. “ But,” Cottrell concludes, “it is essential the new contractor and the old employer understands the process and they should consider seeking professional help to ensure that they can both enjoy the financial and other benefits of their new relationship.”

Published: Thursday, April 8, 2010

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