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## INFORMATION SHEET

### IR35 Notes

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As some clients may be aware, H M Revenue & Customs have recently won a tax case in the High Court concerning IR35 legislation. The case concerns a company called Dragonfly Consulting Limited.

In Dragonfly, the underlying problem was that the contracting company was not aware of the contents of the contract between the agency (through whom the company obtained work) and the end user, but under the IR35 legislation, it is necessary to consider the terms of the notional contract between the contracting company and the end user to ascertain whether this notional contract represents a contract of service (employment) or a contract for services (self employment).

A simplified summary of the case follows at the end of this note, but the message we wish to convey to you is this. H M Revenue & Customs will be much encouraged by their Court success and are more likely to challenge IR35 situations than hitherto.

If your contract is direct with the end user you are in a better position to influence the terms of the contract, but the same principles will apply.

The case appears to have been won by the Revenue on two counts.

The first concerns the substitution clause included in the contract between Dragonfly and the end user of its services. There was a substitution clause in the contract between Dragonfly and the agency with whom it contracted to, but it would appear that the contract between the agency and the end user did not specifically have a substitution clause contained in their contract with the end user. Under IR35 legislation, consideration is required with regard to what the hypothetical contract relationship is between the contracting company and the end user. It would appear in this case, there was no specific substitution clause in the contract between the agency and the end user and when a manager representing the end user was asked about the rights of substitution, he stated that this would never be allowed in practice, thus, overriding the lower contract substitution clause included between the contracting company and the agency. It is important therefore to ensure that anything that is contained within the contractor's contract with agencies is reflected in the agency's contract with the end user. Any deviation from this could lead to H M Revenue & Customs making a successful challenge to the effective self employed status of the contracting company.

Secondly, the Revenue were able to question whether the end user had a right of supervision and control and, again, the end contract between the agency and the end user was quoted as stating that staff supplied by the contractor "*shall be under the full control and supervision of (the end user) on a day to day basis only regarding performance of duties*". When the facts of the contract were looked into it could be demonstrated that the employee of the contractor was actually named in various parts of the contract between the agency and the end user. It was stated that the managers could monitor the contractor's employee's work, check if there was a complaint against him and there also appeared to be ongoing informal appraisal of the quality of his work. It is important to ensure that work undertaken by the contractor's employees is not controlled by the end user but the contractor is purely providing services and that a master/servant relationship should not exist. One has to ensure that the end user cannot move the contractor's employee from task to task or alter the priorities of the work that is being done by him. It is important to ensure that the contract reflects the reality of the contract between a contractor and end user and shows the following:

- A. There is minimal control.
- B. Any substitute clauses included are real and can be exercised (and it would make sense to exercise them when ever possible).
- C. Freedom for the contractor to perform the work as and when it wishes and to be paid on the completion of the task, not on an hourly basis.
- D. The contracting company to make good any defects in the work provided in their own time and for no extra payment.
- E. There should be no mutuality of obligations.

It is likely that the resulting victory in Dragonfly will be quoted by H M Revenue & Customs in future IR35 arguments. However, any contracts that are challenged by H M Revenue & Customs will be dependent on the facts of the case not only by what is contained within the contract but also the reality of that contract, and one must ensure that any clauses contained are not pure shams. If you are dealing with a situation where you have effectively two contracts, ie between the contractor and an agency and an agency and the end user, one must ensure that when the situation is taken as a whole, the contractor and the end user do not have a master/servant relationship, and the reality of areas such as control and supervision should be reviewed to ensure that the end user cannot move the employee of the contractor from task to task or can alter priorities without agreement of the contracting company. One should also consider that there should be no references in the contracts to any specific employee of a contracting company.

Finally, with regard to any reference to a substitute being provided by the contracting company, one must again ensure that the reality of the contract allows this clause to be enacted and that there are not impossible restrictions placed on that right by the end user.

Further information on the Dragonfly case can be found at [www.accountingweb.co.uk](http://www.accountingweb.co.uk), search “Dragonfly”.

We would suggest that if you believe you fall within the realms of the IR35 legislation then you should seek an urgent and realistic reappraisal of your current contracts to ensure that clauses contained in them can be demonstrated to actually work in reality.

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*The above is intended to offer the user general information of interest only. For advice on individual cases, please contact us to arrange a free informal and no obligation initial meeting.*

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