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**ICC IR35 Agency-Contractor contracts - notes**

**1. Background**

- 1.1. The test of whether or not an engagement falls within IR35 was defined by the Inland Revenue in its 'Statement of Modified Approach' in September 1999 as follows:

It is proposed that the new rules will apply to engagements ('relevant engagements') where:

- a worker provides services under a contract between a client and an intermediary; and
- but for the presence of the intermediary, the income arising would have been treated as coming from an office or employment held by the worker under the existing rules used to determine the boundary between employment and self-employment income for tax/NICs purposes, if the individual had contracted directly with the client.

Guidance on the existing rules is included in Inland Revenue leaflet IR56 (available on the internet at [www.inlandrevenue.gov.uk](http://www.inlandrevenue.gov.uk)). The rules will be applied in respect of each engagement, in the same way as they apply to individuals who operate without intermediaries.

- 1.2. It seems clear that in this context,

1.2.1. 'intermediary' means the Contractor's own company and not the agency (although note that there could be complications if the Contractor were also a shareholder in the agency - express advice should be sought in such a case)

1.2.2. on a strict interpretation of the words of the statement, 'client' should mean what we regard as the Agency - but it would be unwise to rely on such a strict definition, and so where it is practicable to deal with matters in such a way, we would be wise when considering the meaning of the legislation to treat 'client' as meaning **either** the party we are accustomed to regarding as the Agency, **or** the Client, or both of them.

- 1.3. I take as a 'given' that the individual Contractor, 'a worker', provides services under a contract between a 'client' (ie the Agency) and 'an intermediary' (ie his/her own company; and I express the remainder of the test as follows:

1.3.1. whether or not, on a true construction of the written contract, the relationship it sets up between the agency and the contractor's company would (as a matter of law) be one of employment, if (hypothetically) the contract had been between (1) the agency/client, and (2) the contractor personally (rather than between (1) the Agency, and (2) the Contractor's company)

and

1.3.2. whether or not that contract actually reflects the true relationship between the agency/client and the contractor.

- 1.4. It is the Contractor's responsibility to take the correct decision on the IR35 status of the contracts (s)he enters, and to account for tax accordingly. Neither the Agency nor the Client play any part in this process, or have any responsibilities (either to the Inland Revenue, or otherwise) for the Contractor's decision, whether (s)he be right or wrong.

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- 1.5. If the Revenue seek to question or challenge a Contractor's decision on the IR35 status of a contract, the first thing they are likely to do is to call for a copy of the Agency-Contractor contract. They are also likely to ask the Contractor various questions, both about the position itself, and also about the background and history of the contractor's business.
- 1.6. I have considered the legislation (presently in draft), the Inland Revenue's guidance on the existing rules in IR56, and their more recently published guidance in relation to the way they propose to apply the tests for IR35; and I have further considered the background of case law on the question of when an individual is and is not an employee; it is important to note that the Inland Revenue guidance in IR56 and in their later-published guidelines **can do no more than present their own interpretation** and summary of this case law; it is the **case law which is the legal authority** on which the Inland Revenue must depend. If there were a conflict between the case law and the IR guidance, and if that conflict were to come before the Courts, then it is the case law on which the Courts would rely to reach a decision - the Inland Revenue could do no more with their guidelines than use them as argument, since the guidelines do not amount to legal authority.
- 1.7. I have also had extensive experience over the past 5 years of advising a large number of Contractors and Agencies on various matters arising from or relating to their contracts. In that context, I have considered the contractual documentation of well over 200 agencies. Consequently I have wide experience both of the nature of such contracts and of the relationships they govern; and of the wide variety of things which can go wrong - many of which could be prevented (or made easier to resolve) with better contract drafting.
- 1.8. Based on my research and experience, I have reached the conclusions that
  - 1.8.1. The actual relationships Contractor-Agency and Contractor-Client in the majority of Consultancy positions are capable of quite legitimately falling outside the scope of IR35; however,
  - 1.8.2. The wording of virtually all Agency contracts currently in use is likely to cause those relationships to be brought within IR35. Indeed, the Revenue themselves recognise this - their most recent guidance notes refer to what they term as 'standard form' agency terms, which (they say) '*typically require the worker to work on the client's premises, use the client's equipment, work standard hours, be paid at an hourly rate, and be subject to a high level of control*', and say that they will treat engagements under such contracts for longer than 1 month as being subject to IR35 - and where that is what the contract terms say, then the Revenue may well be (legally) correct in doing so.

In other words, it is generally the terms of the Agency contracts themselves which will (unless changed) shoot in the foot the Contractor's opportunity to (perfectly legitimately) treat the contract as being outside the scope of IR35. It is our intention here to provide terms which *do not* of themselves result in an engagement falling within IR35.
- 1.9. IR35 is deeply unpopular with Contractors.
  - 1.9.1. Where it takes effect, it will reduce their after-tax income by 15-20%. It is only natural that anyone, faced with such a dramatic change to their tax position and challenge to the way in which he or she has organised his/her life, will try to find ways round it.
  - 1.9.2. Agencies which accept contract terms which are 'IR35-friendly' will be in a much stronger position to compete against the background of the new legislation,
  - 1.9.3. The rates such agencies offer to Contractors can be offered with the confidence that the Agency contract terms will not themselves prejudice the Contractor's IR35 position.
- 1.10. The draft legislation suggests that when approaching the IR35 decision, the Revenue are to take into account '*the terms of the contracts forming part of the arrangements under which the services*

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are provided'. The Revenue have suggested that this may also include the Client-Agency contract. However, where (as is usual) (1) the Contractor is not a party to the Client-Agency contract, (2) the Contractor has not seen that contract, (3) the Contractor does not have the right to see it, and (4) the Contractor cannot therefore be bound by its terms, then it is very difficult to see how (s)he can be expected to take into account the terms of that contract when assessing and accounting for his/her tax liabilities.

1.11. The overall objectives here are therefore

1.11.1. to provide contract terms which set a background for the wide variety of engagements which may be entered between Contractors and Agencies, and which will permit the Contractor to take his/her own decision (possibly after taking advice, and after obtaining an Inland Revenue ruling) as to the correct IR35 status of the position, based on the relationship of the position itself and the Contractor's personal and business position, and without having been 'shot in the foot' by the terms of the Agency-Contractor contract itself

1.11.2. to do so in a way which does not significantly increase the Agency's commercial risks, or its administrative burden.

1.12. Finally, to reinforce the point: it is not for one moment suggested that anything illegal or in any way improper should be done or acquiesced in, or that any part should be played in evading any taxes that are properly and lawfully due. All we seek to do is to define the contractual relationships in such a way that more accurately reflects the reality of what is happening and of what the Contractor is doing, so as to enable him/her to ensure that (s)he pays the proper taxes, and **no more** than that. There can be no question that to do this is anything less than 100% legitimate.

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## 2. Pointers towards ('EP's) or away from ('NEP's) and employment-type relationship, derived from the Inland Revenue's guidance, and case law

- 2.1. **Control** - the more the contract specifies that the Contractor is subject to the control of others in **what** (s)he does, **where** or **when** (s)he does it, or **how** the Contractor's work is to be done, the more this points towards employment. Control over all four of these would be a strong employment pointer ('EP').

We deal with this by defining in the contract itself, so far as practicable, the questions of **what**, **where**, **when** and **how**. Such matters can then be properly said to be items the Contractor has expressly **agreed to in advance**, when deciding whether or not to enter the contract, rather than matters where (s)he is **subject to control**.

To the extent that they cannot be wholly defined in advance, provision is made for changes to be subject to some objective standard (which can be argued as not therefore amounting to *control*), or to the Contractor's *agreement* at the time; again, it can be argued by the Contractor that where (s)he cannot be required to do something without his/her *agreement*, (s)he cannot properly be regarded as subject to *control* on the point.

**What:** where practicable describe the Contractor's role in terms of production of specified deliverables; failing that, in terms relating to the undertaking of a specific project or task, rather than a role or position title. See also 2.7, and the examples in the Contract Schedule.

**Where:** the work location should be defined where practicable to the Client's address, and possibly also (subject of course to agreement of both Contractor and Client) to the Contractor's own premises.

**How:** objective standards for the work are included, as opposed to requiring the Contractor to work under the Client's **control**.

**When:** working hours are defined. It may be preferable to avoid specifying actual times, and instead say 'at such times as may be agreed'. But if the Contractor insists on specifying times, do so.

- 2.2. **The right to appoint a substitute** or take on an assistant - if the Contractor has this right, then it's a strong non-employment pointer ('NEP').

Given that the Client will almost certainly have interviewed and approved the Contractor personally, this is probably the most problematic of the pointers. However, the right to appoint a substitute is such a strong non-employment pointer (so strong indeed that there is some legal authority for saying such a right **alone** (provided it is a real right, and not just hypothetical) may be sufficient to ensure that a relationship **cannot** be regarded as employment, without the need to consider any of the other factors) that it would be a pity not to try and cover the point.

In most situations, it will be primarily the Contractor's particular skill-set and experience that determine whether or not a Client offers a contract, with issues of personality etc still of importance but nevertheless secondary.

In the Contractor's contract we deal with this by stating that specifically defined services are to be provided, by such individuals as the Contractor proposes and as the Agency (for itself and for the Client), accept. A side letter, signed at the time of the contract, operates as the Agency's approval of the individual Contractor. It remains open to the Contractor to propose an substitute, and to the Agency to accept or decline. This in fact follows the pre-IR35 practice of a few agencies, and is not (so far as I am aware) known to have resulted in problems in practice.

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We also give the Contractor the express right to appoint assistants in connection with any work carried on off-site, at his/her own cost. The fact that such assistants are at the Contractor's own cost may make it unlikely that a Contractor will in fact seek to exercise that right, but if (s)he does do so then issues of confidentiality etc are also covered. Even if the Contractor has the right to appoint an assistant but does not do so, that may of itself be an IR35-positive factor for other reasons - in relation to pointers 2.4 (financial risk) and 2.6 (opportunity to profit from sound management).

- 2.3. **Provision of equipment** - where the major items of equipment a Contractor uses are provided by a Client, this is an EP. It seems reasonable to argue that the Client's computer system on which a Contractor may be working is not an item of equipment, but more akin to eg the washing machine a repairman is servicing, the subject of the work, rather than a tool or piece of equipment used to perform the services. Most Contractors however will have their own home-office of some sort, PC (and possibly laptop), car, and mobile phone, and so it seems a pity to miss the opportunity to *require* them to provide these items for their own use in the course of the contract - or at least such of them as they do in fact provide - and thus gain not only an NEP, again in relation to this item, but also another NEP in relation to pointers 2.4 (financial risk) and 2.6 (opportunity to profit from sound management).

Provision is made in the schedule for such equipment as is provided to be specified, according to what a contractor is able to provide.

- 2.4. **Financial risk** - the more the Contractor is at risk (whether of not being paid, or of making a loss - eg by buying equipment, or working on a fixed price basis, or of having to put right mistakes in his/her own time or pay compensation for consequences of defective work), the stronger the NEP.

The reference to a fixed price basis is something we accept can probably do nothing about - the essence of Contractor-Agency relationships is that they are almost always paid on a time basis.

Significant investment in training to provide skills which can then be used in engagements may be an NEP under this heading - especially if there is a real risk that such investment might not be recovered from income in future engagements.

The other points, to a greater or lesser extent, can be provided for. Reference has already been made to two of these, in 2.2 & 2.3.

Payment against invoice carries a risk of not being paid, and is recognised by the Revenue as being a minor pointer under this heading.

Terms expressly providing for the contractor to carry out work to particular standards will strengthen the Contractor's IR35 position here.

- 2.5. **Basis of payment** - payment on a fixed price basis is said by the Revenue to be an NEP, payment by the hour is the opposite.

However, the timesheet itself need be of no more significance than simple confirmation of the time for which payment is charged. Payment on a time basis is common in cases of contracts for consultancy services.

In cases of employment on the other hand, employees performing similar functions to a Consultant would almost invariably be salaried, ie paid at an annual rate, regardless of the actual number of hours worked.

Whilst in the case of persons who **as employees** would generally expect to be paid on a time basis, payment under a contract via an intermediary on a time basis might be considered an employment pointer, the opposite surely must be the case, when considering persons who (if they were employees) would **not** expect to be paid on a time basis.

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Payment on a time basis **in a contract for consultancy services** is therefore arguably a characteristic of **self-employment**, not employment. It is considered that the true question to be answered is whether or not the basis of payment is a characteristic of employment or self-employment, viewed against the background of the nature of the contract.

It would not be consistent with legal authority to simply claim that 'payment on a time basis is a characteristic of employment'.

In any event, the reference to a fixed price basis is something we accept can probably do nothing about - the essence of Contractor-Agency relationships is that they are almost always paid on a time basis.

- 2.6. **Opportunity to profit from sound management** - the ability to make more profit by containing overheads and effective organisation of work is an NEP. Again, some overlap with the concept of a 'fixed price' basis of payment.

Again as stated above, the reference to a fixed price basis is something we accept can probably do nothing about - the essence of Contractor-Agency relationships is that they are almost always paid on a time basis.

Reference has already been made to this, in 2.2 & 2.3.

- 2.7. **The extent to which the Contractor is part and parcel of the Client's organisation** - other things being equal, a contract under which a Contractor who is engaged to manage a Client's own staff is more likely to be treated as an ETC than one under which a Contractor is providing something more akin to straightforward consultancy, producing its own deliverables.

As stated under 2.1, (What), where practicable, describe the Contractor's role in terms of production of specified deliverables; failing that, in terms relating to a specific project or task, avoid a role or position title - especially 'manager' - in such a case instead say eg 'Management of client's project (project name), and such other project(s) as may from time to time be agreed'. Examples are given in the Contract Schedule.

- 2.8. **Right of dismissal / termination** - the right (by one party or the other, or both) to terminate on notice (ie without cause) is an EP.

The Revenue seem to be under the impression that such rights are not common in contracts for services. You and I know that it is virtually unknown for an Agency or a Client not to have the right to terminate on notice - and that more often than not Contractors also have (and expect to have) such rights.

I have therefore retained the right to give notice without cause. In my view the commercial risks to both parties are likely to outweigh the desire to produce IR35-friendly terms.

- 2.9. **Employee benefits** - sick and holiday pay, pensions, & expenses are (especially in longer contracts) EPs.

Clearly, we can and do expressly exclude these.

- 2.10. **Length of engagements** - long engagements, or regular working for the same agency / client, may be EPs.

Not something to be covered by the contract, save to say that I find it very difficult to imagine that an engagement of 6 months or less would, other things being equal, create a problem; and unlikely (though not impossible) that an engagement for 1 year would do so. Where on the other

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hand a Contractor has been continually renewed by a client for years on end, then there certainly comes a point where he will be at significant additional risk as a result of this pointer.

However, where the rate is good, a long engagement may in fact amount to no more than a demonstration of sound management, and arguably not an EP at all.

- 2.11. **Personal factors** - things within the Contractor's sole control, and not in the contract itself; basically, for the Contractor to act as though (s)he is genuinely running a business, rather than acting as an employee - eg expenditure on office accommodation and equipment, and PI insurance - is an NEP.

We have already covered requiring the contractor to provide his own home-office, and equipment. The contract should expressly allow the Contractor to accept other work outside the hours committed under this contract.

A requirement to provide PI insurance may not be acceptable to many contractors - in my experience only about 20% do so. Whilst I nowadays advise Contractors that it may be an IR35 plus to take out such insurance, the premiums are not cheap. From a commercial point of view it is probably better not to expressly **require** such insurance.

- 2.12. **Declared Intention** - an easy one, this; the contract should expressly state that the Contractor is not an employee of the agency or the client. A minor point, but it may help. An easy NEP.

Such a declaration is included.

### 3. Approach

- 3.1. Terminology ought not to be important; however, it creates impression, and may therefore be subliminally persuasive. For this reason the 'Contractor' is referred to throughout in these documents as the 'Consultant'.
- 3.2. Similarly, it is important to avoid what might be regarded as the 'language of employment' - so such terms as 'position', '(mis)conduct', 'overtime', 'pay rate', 'reporting to', etc are (where practicable) paraphrased or side-stepped.

### 4. In Practice

- 4.1. Where case-specific alternatives are to be inserted, examples are given of the kind of wording to include.
- 4.2. Be careful about adding additional clauses, or changing the wording of the body of the terms themselves - there may be undesirable side-effects.

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**5. Role / Position / Services**

5.1. Where before IR35 a position / role / title would have been used in the contract, instead

**5.1.1. use a project-based task description;**

**5.1.2. be as specific as you can;**

**5.1.3. where possible, relate it to a specific named project;**

**5.1.4. specify at least the primary required skills;**

**5.1.5. include the general words at the end, for 'such other projects / tasks as may from time to time be agreed.'**

<b>Instead of</b>	<b>Say:</b>
Analyst/Programmer Developer	Consultancy Software Services - Development and delivery of software code in connection with <i>[project name]</i> , using <i>[relevant languages / skillset]</i> , in line with the overall project specifications for the project, as amended from time to time; and such other related tasks as may from time to time be agreed.
Business Analyst	Business Analysis Consultancy, in connection with <i>[project name]</i> ; and such other related tasks as may from time to time be agreed.
Project Manager	Consultancy Management Services, in relation to Client's project <i>[project name]</i> , and such other projects as may from time to time be agreed
Support	Consultancy Support services, in connection with <i>[project name]</i> , and such other projects as may from time to time be agreed
Software Tester	Consultancy Software Services - testing of software code in connection with <i>[project name]</i> , using <i>[relevant languages / skillset]</i> , in line with the overall project specifications for the project, as amended from time to time; and such other related tasks as may from time to time be agreed.
Database administrator	Consultancy Software Services - system and database administration in connection with <i>[project name]</i> , using <i>[relevant languages / skillset]</i> , in line with overall system parameters, as amended from time to time; and such other related tasks as may from time to time be agreed.
Network Engineer	Network Consultancy Support services, in connection with <i>[project name]</i> , and such other projects as may from time to time be agreed
Other roles	Consultancy <i>[type of service]</i> Services, in relation to <i>[project]</i> , and such other projects as may from time

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	[project], and such other projects as may from time to time be agreed
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- 5.1.6. It is accepted that there will be certain 'roles' which cannot realistically be expressed in the above format. The best advice I can offer is to say 'do what you can according to the general format '*Consultancy [type of service] Services, in relation to [project], and such other projects as may from time to time be agreed*' - but accept the fact that there will be some roles which simply cannot be expressed in such a way.
- 5.1.7. In general, this documentation has been designed for professionals, accepting specific assignments, and for which they will accept a degree of professional responsibility; the individuals concerned are genuinely not submitting to control in what they do, and in where, when and how they do it - they are, in a word, acting as 'Consultants'.
- 5.1.8. Where the role to be filled cannot in fairness be described as that of a Consultant, then It must be accepted that it is probably also the case that the remainder of these terms are also inappropriate for such a position.

## 6. England/Wales; Scotland

- 6.1. These terms are stated (last item of the Contractor's terms) to be subject to English law, & to the exclusive jurisdiction of the Courts of England & Wales. The terms are equally suitable to Scotland and Scottish law - just make the appropriate changes here.

Roger Sinclair, Egos Ltd

April 2000

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