



## IR35 – HOW IT AFFECTS CONTRACTS

This note uses 'contractor' in the loosest sense, meaning anyone who is doing work outside a conventional employment relationship.

### Why does IR35 affect contracts?

Organisations want to avoid unexpected bills for tax and national insurance – let's call it 'IR35 risk'. When drafting contracts for services that might feasibly involve contractors, organisations will be tempted to use contracts to re-allocate the risk of HMRC demanding back payment of tax and NI.

### How could contracts re-allocate IR35 risks?

An organisation (usually the customer in a contract for services) wanting to re-allocate IR35 risks to someone else will typically opt to use one or more of the following mechanisms:

- Impose a warranty that says no contractors will be used in the performance of the contract (opening the door to compensation if contractors are used)
- Impose a warranty that says the service provider pays tax and NI for all personnel performing a contract
- Service provider has to indemnify the customer for any HMRC demands for tax or NI
- Customer reserves the right to make its own assessment of IR35 risks and deduct tax at source before paying the service provider.

### So what?

The problem is that standard form contracts might not align to the reality of a project that does require work from contractors. In such cases, the parties need to face the reality and use more specific contract clauses that deal with the risk without blocking the project.

The issues outlined above tend to originate in contracts for services, but they increasingly flow down the supply chain, as each party in the supply chain tries to lay off the risk. Eventually, the risk can arrive back with the contractor. Since many contractors won't have the financial means to pay the compensation, the arrangement isn't as assured as it might look.

### Mitigating contract risk

The key to mitigating contract risks to a sensible level for everyone in a supply chain is to make sure that contractors are properly assessed to ascertain who should pay the tax and NI. It follows that contractors (and their agencies) can negate the risk by placing the contractor in a scheme where tax and NI are deducted correctly.

### Historical treatment of contractors – inconvenient issues

Many commercial contracts have something to say about the use (or restricted use) of 'subcontractors', especially now that data protection issues are so significant. Most suppliers have opted to ignore the role of contractors, preferring to give the impression that a project is staffed by their own employees. It seems likely that contracts will now deal specifically with contractors to negate IR35 risks. When the use of contractors becomes known, it's not hard to anticipate that customer organisations will consider whether the 'subcontractor' provisions of contracts should apply to contractors. If that happens, individual contractors might find they are exposed to contract regimes that are uncomfortable for a contractor.

**If you have any questions about IR35 and the affect it may have on your business, talk to us.**



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