

# Contractors and IR35 Compliance: Avoiding Common Pitfalls

For contractors in the UK, understanding and complying with IR35 is one of the most significant challenges they face. The introduction of the IR35 legislation, aimed at preventing tax avoidance, has had a profound impact on how contractors structure their contracts and manage their finances.

Navigating the complexities of IR35 is critical, as non-compliance can lead to hefty tax bills, penalties, and even legal trouble. In this article, we'll explore the relationship between contractors and IR35, highlighting common pitfalls to avoid and offering practical tips for staying compliant.



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# What Is IR35 and Why Does It Matter for Contractors?

Before diving into the common pitfalls and strategies to avoid them, it's essential to understand the core principles of IR35 and why it plays such an important role for contractors.

IR35 is tax legislation introduced by HMRC in 2000 to combat "disguised employment." Disguised employment occurs when a contractor operates through a limited company (or another intermediary) but works in a manner that is essentially the same as a permanent employee. In these cases, the contractor would avoid paying employee taxes like National Insurance and income tax, leading to tax avoidance.

When a contract falls "inside IR35," the contractor is treated as an employee for tax purposes, which significantly reduces their take-home pay. If the contract is "outside IR35," the contractor is treated as genuinely self-employed and can take advantage of more favorable tax treatment.

Given the financial implications, contractors must be vigilant in ensuring that their contracts are compliant with IR35 regulations. The following sections will outline common pitfalls and provide strategies for IR35 and contractors to avoid them.

## Common Pitfalls Contractors Face with IR35 Compliance

While the [rules surrounding IR35](#) may seem straightforward, many contractors and businesses alike struggle with compliance due to the nuanced nature of the legislation. Here are some of the most common pitfalls that contractors encounter when dealing with IR35 compliance.

# 1. Misunderstanding Employment Status

One of the most significant issues contractors face is a misunderstanding of their employment status under IR35. Many contractors assume that working through a limited company automatically places them outside of IR35. However, the reality is more complex.

## Key Factors that Determine Employment Status:

- **Control:** How much control does the client have over the work you do? If the client dictates how, when, and where you work, you may be inside IR35.
- **Substitution:** Are you allowed to provide a substitute if you are unable to fulfill the contract? The right to substitution is a strong indicator of an outside IR35 contract.
- **Mutuality of Obligation:** Does the client expect you to accept work, and are you obligated to do so? If so, this could signal an employment relationship.

# 2. Ignoring Contract Details

Your contract is a critical piece of evidence when determining whether you fall inside or outside IR35. Many contractors and clients fail to carefully review and update their contracts, leading to discrepancies between the contract and the actual working practices.

## Common Contract Errors:

- **Vague Terms:** Contracts with vague or unclear terms regarding the nature of the work and how it is carried out may raise red flags with HMRC.
- **Lack of Right to Substitution:** Contracts that don't clearly outline the contractor's right to provide a substitute may be seen as an employment relationship.

- **Mismatch Between Contract and Reality:** If your contract states that you're self-employed but your working practices reflect employee-like behavior, HMRC is likely to consider you inside IR35.

### **3. Failing to Use a Contract Review Service**

A simple yet overlooked strategy for ensuring IR35 compliance is using a professional contract review service. Many contractors skip this step, assuming they can assess their contract themselves. However, IR35 legislation is nuanced, and a small oversight could have costly consequences.

### **4. Poor Record-Keeping**

Another common mistake contractors make is not keeping thorough records of their engagements, expenses, and interactions with clients. In the event of an HMRC investigation, having detailed documentation is essential to prove that your contract falls outside IR35.

### **5. Assuming All Clients Understand IR35**

One of the more surprising pitfalls is assuming that the client (particularly small businesses) fully understands the nuances of IR35 and contractors. Some clients may incorrectly assess IR35 status or fail to engage in meaningful discussions about how the working relationship will impact the contractor's tax position.

## **How Contractors Can Avoid IR35 Pitfalls**

While IR35 compliance can seem daunting, there are steps contractors can take to minimize risk and avoid the common

pitfalls discussed above. Here's a guide to help you stay on the right side of IR35:

## **1. Review and Update Contracts Regularly**

Your contract is the primary document that will be scrutinized if your IR35 status is questioned. Ensure your contract clearly reflects a self-employed status. Contractors and IR35 compliance depend heavily on the following:

- **Right to Substitution:** Make sure your contract explicitly states that you have the right to send a substitute to fulfill the work if needed.
- **Control Clauses:** Limit the client's control over how and when you complete your work. The more freedom you have to carry out tasks in your own way, the better your chances of being considered outside IR35.
- **Mutuality of Obligation:** Ensure that the contract doesn't imply an ongoing obligation for work, which could suggest employment status.

## **2. Align Your Working Practices with Your Contract**

Even if your contract is compliant with IR35, your actual working practices must reflect what is stated in the contract. IR35 contractors should ensure that their day-to-day working relationship with the client mirrors what is written in the contract.

### **Key Practices to Follow:**

- **Set Your Own Hours:** Avoid letting the client dictate your work hours.
- **Work Off-Site:** When possible, work off-site to reinforce your independence from the client.

- **Use Your Own Equipment:** Providing your own equipment, rather than using the client's, is another strong indicator of being outside IR35.

### **3. Use an IR35 Contract Review Service**

To ensure your contract is fully compliant with IR35, consider using a professional contract review service. These services are equipped with expertise in IR35 and contractors and can help identify any clauses that might suggest employment rather than self-employment.

- **Expert Assessment:** Get an expert to review your contract before starting work. They'll look for any red flags that could indicate you're inside IR35.
- **Recommendations for Changes:** A contract review service will offer suggestions on how to improve your contract and working practices to ensure compliance.

### **4. Keep Detailed Records**

As a contractor, it's essential to maintain comprehensive records of your business dealings in case of an HMRC investigation. Keeping accurate records will help you demonstrate that you operate as a genuine business.

#### **Key Records to Keep:**

- **Contracts and Invoices:** Store copies of all contracts and invoices to demonstrate that you're operating as a business.
- **Emails and Communication:** Keep a record of email exchanges, especially if they relate to the right of substitution or how the work is being completed.
- **Expense Receipts:** Ensure you keep receipts and documentation for all business expenses to substantiate

your self-employed status.

## **5. Have Open Discussions with Clients**

It's important to have clear and open conversations with your clients about your IR35 status, especially if the client is responsible for determining it. This is particularly crucial if you're working with larger companies or public sector clients, who now have the obligation to assess IR35 status under the 2021 off-payroll working rules. Miscommunication can lead to errors in determining whether you fall inside or outside IR35, so it's in your best interest to make sure that both you and the client are on the same page.

### **Key Discussion Points with Clients:**

- **Clarify Expectations:** Make sure that both parties understand how the work will be carried out, and that the arrangement is structured in a way that supports an outside IR35 status if applicable.
- **Discuss the Right to Substitution:** Ensure the client is aware that you, as the contractor, have the legal right to provide a substitute if needed.
- **Review Working Practices:** Regularly check with your client to ensure that the working relationship continues to reflect what is stated in the contract.

## **Conclusion: Staying Compliant with IR35 as a Contractor**

For contractors, IR35 compliance is a complex but critical aspect of managing your business and avoiding unnecessary tax liabilities. By understanding the key principles of IR35 and taking proactive steps to review your contracts, align your working practices, and keep detailed records, you can avoid

the common pitfalls that often catch contractors off guard.

By staying informed, vigilant, and proactive, contractors can navigate the challenges of IR35 and continue to operate successfully in the UK's contracting market.