

## **Dragonfly - what should contractors do now?**

HM Revenue & Customs won an IR35 case at the High Court in 2008 that struck fear into the contracting world.

Many contractors had merrily gone along thinking they had a silver bullet to get outside of IR35, only to read the Dragonfly decision and conclude that the silver bullet was only made of belly button fluff – useless.

Whilst contractors and their advisers should not be complacent, they should consider why the taxpayer lost as the news isn't quite as bad as everyone thought.

Two key aspects of the case are discussed below:

### **Substitution**

One critical part of HM Revenue & Customs proving that IR35 applies is that the contractor must be required to give personal service to the end client. Therefore if the contractor has the right to send a substitute in their place, there can be no personal service and IR35 cannot apply.

I have heard some commentators say that “a substitution clause in a contract used to be enough to get outside IR35 but since Dragonfly that's changed”. That's not quite the whole story.

What has always been important was whether you had a genuine right to send a substitute, not whether you had a clause that said you could. Merely inserting the clause into your contract with the agency was never going to be enough if it didn't reflect reality or you needed the client's permission.

The Court decided in the Dragonfly case that the substitution clause was not genuine because:

- The contractor had never sent a substitute
- The contract between the client and agent did not mention any right of substitution clause (even if the contract between Dragonfly and the agent did)
- The client was thought to have selected the contractor and did not want him to send anyone else
- Some contracts specifically referred to the contractor (rather than his company).
- One of the managers from the client said that they would not accept a substitute.

This highlights two key issues:

- The terms of the contract between the agency and end client (upper contract) may be inconsistent with those agreed between the agency and the contractor's company (lower contract).
- The written contract may not have reflected what happened in practice.

The problem is that a contractor is unlikely to ever see what the agency has agreed with the end client, although it would never hurt to ask. How can contractors protect themselves if they seek to rely upon a substitution clause as part of their IR35 defence strategy?

Agencies should be asked to confirm that the agency/client contract mirrors that of agency/contractor contract. Where this confirmation is not forthcoming, contractors should go direct to the end client and ask for written confirmation that they accept the contractor's right to send a substitute (normally part of a real arrangements letter).

What's in it for the client, after all isn't IR35 the contractor's problem? Real arrangement letters can be useful in bringing IR35 enquiries to a swift end, minimising the involvement of your client's staff. That has to be good news for both sides.

Finally, actually sending a substitute in your place has got to be a very strong indicator that a contractor's right of substitution is genuine.

### **Control**

Another key factor in IR35 is whether the end client has control over the contractor. It was previously thought that control meant how the work was done, but the decision in Dragonfly goes further than that by looking at the way the work is allocated, monitored and supervised.

Contractors should look for terms in their contracts that say that the contractor has the right to decide the method of performance of the duties and be careful of contracts that imply excessive levels of supervision. The real arrangements letter is the ideal opportunity to confirm matters in relation to control.

### **Contracts in writing**

Most advisers to the contractor profession maintain that it is always better to have a written contract than not. Dragonfly served as a useful reminder that written contracts must reflect the reality of the business relationship, rather than simply agreeing a set of IR35 friendly terms.

### **Contract reviews**

Baker Watkin complete contract reviews for their contractor clients for IR35 purposes and are members of the Professional Contractors Group (PCG) Quality Accountant Scheme. If you are a contractor and would like to find out what being a client of Baker Watkin might be like, please contact James Abbott.