

IR35 Survival Kit

Since it was introduced, IR35 has been a thorn in the side of contractors, causing concern and confusion in an ever expanding industry. There are countless misconceptions and misinterpretations of IR35, so we thought it necessary to once and for all arm contractors with the right toolst to confidently take control of their IR35 status.

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All contractors who are operating through a limited company and paying themselves in dividends are at risk of an IR35 enquiry. The key is to ensure that your stall is set out in advance so that you can build the best possible defence should HMRC come knocking. Evidence is vital and it's important that you prove that you have taken the due diligence in determining your position from the outset.

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Ex-HMRC Inspector

The following documents/tools and guidance have been constructed by tax and IR35 specialists, led by ex-HMRC inspectors and contract and status experts.

Your survival kit includes:



Key Facts



DIY Contract Review



The Dreaded HMRC Letter



Liability Checker



Step-by-Step IR35 Enquiry



Common Myths



Evidence Checklist

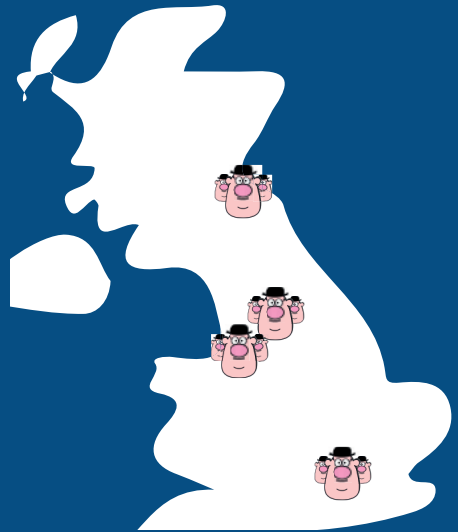


What Can Qdos Do to Help?



Key Facts

- HMRC introduced the 'Intermediaries Legislation' that became known as IR35 in 2000 after it was announced in the 1999 Budget.
- The legislation was introduced to combat 'disguised employees'. This refers to an individual who would be treated as an employee were it not for the fact that they provide their services via their own personal service company.
- Contractors working via limited companies are not liable to pay NICs on income taken as dividends, resulting in far less tax to the Treasury. As a result of this, IR35 exists to ensure that those working in this manner pay the tax they should.
- Being 'caught' by IR35 can have serious financial consequences. If the Revenue investigate a contract and decide that it is inside IR35, they will calculate a deemed payment treating all income received from the contract as salary and demanding PAYE tax and national insurance contributions on payments originally paid out as dividends.
- HMRC can go back up to six years, so even if a contract is finished there is still a risk that it could be subject to an enquiry.



HMRC now have four specialist teams tasked solely with enforcing IR35. Each team has ten officers supported by status inspectors, with the potential to open up to 2,000 enquiries per year (although HMRC have stated that we shouldn't expect such a high volume). The teams are situated in Croydon, Salford, Edinburgh and most recently, Bradford.





The Dreaded HMRC Letter

If you do receive an IR35 enquiry letter from HMRC it is important that you seek professional advice immediately.

Receiving that dreaded letter from the Revenue is a situation that most contractors will fear, and rightly so, given the tactics and strategies used by HMRC.

IR35 is not an issue that you should deal with on your own as there are numerous potential potholes that the inexperienced could fall into. Unfortunately HMRC know this all too well, and correspondence is often filled with leading questions, effectively designed to catch the contractor out. Having a professional expert handling your case from the outset is worth its weight in gold, as they will know all the tricks of the trade.

Below is an example of HMRC's standard opening letter, with the specific paragraph relating to IR35. It is important that the response to this is carefully considered as HMRC will pick up on anything that suggests you are 'inside' IR35.

In an ideal world, the contractor would provide detailed evidence at this stage in the hope of warding HMRC off as quickly as possible. The likelihood is, however, that the Revenue will want to delve far deeper into the contractor's circumstances.

Will you please also tell me whether you have considered the possibility of the company being subject to what is commonly referred to as the IR35 legislation? If you have, and have concluded that the company is not subjected to that legislation then please explain to me the basis upon which you arrived at that conclusion. I am asking this to help me be fully aware of and understand any view you may hold on the application of the IR35 legislation.



Step-by-Step IR35 Enquiry

An actual IR35 enquiry is made up of four major steps. These are:

- The opening letter
- The initial response
- HMRC correspondence
- The conclusion



Step 1

All IR35 enquiries begin with an opening letter from HMRC. This will concentrate on either a tax year, or the company's accounting period. What contractors must be aware of is that HMRC can go back as far as six years into a limited company's history, but normally in an opening letter the Revenue will initially only concentrate on the one tax year.

The letter usually requests:

- Analysis of company's income falling in the period of enquiry.
- Analysis of certain expenses, mainly travelling expenses incurred in the period of enquiry.
- Copies of all contracts falling in the period of enquiry.
- Factors considered to place the company's contracts outside of IR35.
- Contact details of end client(s).



Step 2

The next step of an enquiry is for the contractor to respond to HMRC's initial letter, and this is a stage that in many cases, proves to be detrimental to the contractor. We advise that the response to HMRC is something that is not tackled without proper guidance. We at Qdos can aid in this response process, and if the evidence provided in response to HMRC's initial letter is to the Revenue's satisfaction, then the enquiry will be closed down, thus highlighting the importance of this stage.



Step 3

If a contractor's response fails to satisfy HMRC, then a meeting may be requested, commonly between two compliance officers and the contractor to establish the working practices. It is important to remember however that HMRC cannot insist on a meeting so should a contractor feel uncomfortable about such a prospect they can politely refuse and request that the enquiry continue by correspondence.

Following a meeting, HMRC will weigh up the evidence that was presented, and if satisfied will conclude the enquiry. If not, then they are likely to contact the end client to test the evidence provided to date. This is an especially dangerous time in an enquiry, as obviously the contractor is helpless, meaning that there is no idea what is being said between the Revenue and the end client. This period is one fraught with risks, and is something that should be carefully managed.

From this point, a sort of 'to and fro' argument begins, and it is this period that usually takes the most time, with cases reportedly lasting as long as five years, although the Revenue has now promised to execute IR35 cases in a considerably shorter time.



Step 4

The final stage of an enquiry is obviously the conclusion. HMRC will make a decision as to whether the contract(s) fall inside or outside of IR35. Should HMRC conclude that a contract is caught by IR35, the contractor has a right of appeal against the decision. If necessary, the appeal can be progressed to Tax Tribunal. This should however be seen as a last resort due to the costs involved. Before considering taking an appeal to tribunal, request an independent review and/or make use of HMRC's Alternative Dispute Resolution (ADR) service. Obviously, if it is determined that you are not working compliantly, and are caught by IR35, then you will be expected to pay out a considerable sum of money. For estimates of your tax liability, we have included an IR35 liability checker within this survival kit that will give you an approximate calculation of the money you would owe if found to be inside IR35.



Evidence Checklist



“Evidence is vital and it is very important that you prove that you have taken the due diligence in determining your position from the outset.”



Below is an evidence checklist created for you to self-satisfy your working status.

Evidence	Description	
Expert contract review	You should be able to demonstrate that you have taken due diligence in confirming your IR35 position. A contract and working practices review from a specialist is the best way to do this.	
Company stationery	Letterheads, business cards and a company website all help to show that you are genuinely in business on your own account	
Business insurance	As a business you should carry necessary insurances including Professional Indemnity and Public Liability cover	
Confirmation of arrangements	The best form of evidence in an IR35 enquiry is confirmation on your actual working practices directly from the end user. Unfortunately many organisations are reluctant to sign documents like this, but it's hugely beneficial if possible	
Supporting documentation	Anything else that points towards you being different to a permanent employee of your client, i.e. security badges, phone lists and other documentation	
Legal Opinion	A step further than a contract review would be to get a legal opinion on your IR35 status from a qualified solicitor. This is likely to be backed by their own PI insurance should any advice turn out to be negligent.	



DIY Contract Review

The written contract will be one of the first things that HMRC will look at in an enquiry, so it's important that you ensure that it is as strong as possible from an IR35 perspective. You should always get your contract reviewed by a specialist, but it is also beneficial if you understand the basics of what both HMRC and your IR35 expert will be looking for.

What to look for:



Right of substitution

There should be a clause in the contract which states that your company can send a replacement contractor should the need ever arise. You have entered into a business to business agreement and not one of personal service. Therefore, your company should be able to provide the services using whichever representatives it sees fit.

Important points:

- Your company must remain responsible for paying any substitute and for the successful completion of the services
- The agency or end user should only be able to reject a substitute on reasonable grounds, i.e. skills, qualification and experience and this should ideally be set out in the clause
- Avoid phrases like 'prior written approval' in terms of the end user's acceptance of a substitute
- If you are named personally in the contract schedule it would be better if the words 'or agreed replacement' were added afterwards



Control

Contracts are often silent on the issue of control. Ideally there will be a clause stating that your company has autonomy over how the services are carried out, but it's also important to look for any negative wording which suggests the opposite.

Important points:

- Look for any clauses which state that you would be 'supervised' or similar by the client
- Hours of work and location should be by agreement between the parties, not dictated by the client
- You should not have set hours like an employee, i.e. 9am to 5pm with an hour lunch break
- Avoid any reference to you having a 'line manager' or having to 'report to' someone within the client's organisation
- There should not be any clauses which state that you have to obtain approval for taking time off



Mutuality of obligation

As an independent contractor there should not be any obligation for either party to offer or provide ongoing work. The project should be clearly defined and any additional services should be agreed in a separate contract or extension.

Important points:

- Ideally the contract should have a clear end date. If the project turns out to run for longer the contract should be formally extended
- The two parties should have equal notice periods for early termination
- Any notice period should ideally not exceed 30 days



Other things to look for:

Financial risk

You should have to rectify any faults or unsatisfactory work at your own time and cost. It is beneficial if a clause is included to state this

Insurance

As an independent business you should carry your own business insurances (Professional Indemnity, Public Liability etc). These are commonly stipulated if you are working through an agency and it's important to ensure that you hold the required levels of cover

Non exclusivity

You should not be contractually barred from carrying out services for other clients. It is helpful if there is a clause stating that you are able to carry out concurrent work

Statement of intent

Many contracts include a clause simply stating that the agreement is designed to be one of genuine independence. It won't make much difference on its own, but it's a good starting point

Equipment

It is good if you are required to provide your own equipment when carrying out the services. Obviously the nature of some projects mean that this won't be possible, but if it is it's worth including reference to it in the written contract

Always double check the final contract

Quite often an agency will initially send a contractor a blank, template contract. This is fine and will ensure that the main terms and conditions can be checked, but you must always have it reviewed again once all specific details have been added. The contract schedule is a common place for agencies to add project-specific information which could have a negative impact on IR35. Also check any appendices or additional terms and conditions that are specific to the end client.



Liability Checker

Most contractors will know that the effects of IR35 can be financially devastating, but to provide clarity, we have compiled this handy IR35 liability checker. This is based on a typical contractor, so will not be exact; for a personal calculation please visit the Qdos Accounting website.

Remember that HMRC can also impose a penalty (i.e. a fine) if a contractor is caught by IR35; potentially up to 100% of the tax bill, although this is only likely to happen in extreme cases.

Day Rate	1 Year worth of tax*	3 Years worth of tax*	6 Years worth of tax*
£200	£5,554	£17,150	£35,757
£300	£7,394	£22,831	£47,602
£400	£8,885	£27,436	£57,202
£500	£10,377	£32,040	£66,802
£600	£11,825	£36,510	£76,121
£700	£15,162	£46,814	£97,604
£800	£16,414	£50,677	£105,657
£900	£17,599	£54,337	£113,290
£1000	£19,300	£58,753	£122,495
			*Including interest

For a more dedicated calculation please visit www.qdosaccounting.com



Common Myths

I've gone over two years at the same place, so I must be caught by IR35

This is possibly the most common misconception surrounding IR35 and one which is often propagated by agencies and end users. The fact is that there is no specific time period after which a contractor automatically becomes 'caught' by IR35; indeed, many contractors have won IR35 cases where they have been with the same client for far longer than two years.

The confusion is probably based on the '24 month rule', which applies to the claiming of travelling expenses to and from a temporary workplace. This has nothing to do with IR35.

Naturally the longer an agreement is with one client, the higher the potential IR35 liability would be. HMRC would also look to argue that you had become 'part and parcel' of the organisation. However, if

your contract and working practices remain compliant throughout there should be no increased risk of you being caught by IR35 regardless of the length of time you've been there.

My agency said the contract is IR35 friendly so I must be safe

Whilst the agency may or may not have taken care to ensure the written contract is carefully worded, they certainly won't know what the actual working practices will be. These will override any written agreement, meaning a contract is worthless if the true facts point towards you being a 'disguised employee'.

Thankfully more and more recruitment agencies are changing their contracts to make them as IR35-friendly as possible, but it is vital that you always ensure that the overall picture is compliant – not just the written terms.

I have more than one client, so I can't be caught by IR35

Whilst multiple or concurrent contracts are certainly a positive indication that you are a 'genuine' business, each engagement will still be considered individually by HMRC. In theory you could be working on two contracts at the same time and one could be 'inside' and the other 'outside'.

If you do have multiple contracts with different clients you must still ensure that the contracts and working practices are compliant.



What Can Qdos Do to Help?

Contract reviews

Our experienced IR35 experts will review your written contracts and actual working practices to ensure that they are compliant. If there are any problems we will give you detailed instructions on exactly how to rectify them and will even liaise directly with your agency if required. We provide a number of review options, from a basic assessment, to a full IR35 defence and evidence pack.

Legal opinion

We are now able to go one step further and provide a full legal opinion of your IR35 status, signed off by a qualified solicitor. This provides contractors with additional certainty as any legal opinion is effectively guaranteed and backed by solicitors' Professional Indemnity insurance.

Tax insurance

Qdos can provide policies to cover all representation costs in any HMRC enquiry, including IR35. This means you will have an expert handling your case and dealing with the Revenue from start to finish.

Accountancy with IR35 management

Qdos combine comprehensive, compliant accounting with expert IR35 assistance. We ensure that all of your requirements are taken care of in one place, by experienced professionals.

Business insurance

We provide low cost Professional Indemnity and Employers & Public Liability that can be purchased online within a couple of minutes. We are continually adding to our product portfolio and now offer a range of other insurance policies, from sickness cover to legal protection.

Enquiry defence

If you are under investigation and don't have insurance we are still happy to help. Our team of consultants are experienced in all areas of tax and can manage any enquiry on your behalf.



Notes



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