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HMRC IR35 Risk Assessment

Overview

The "IR35" legislation, which has now been with us since 2000, was introduced as a means of taxing disguised employment arrangements as if they were employments. Most commonly, it applies to individuals who work, essentially as an employee, of an organisation but supply their services indirectly through their own limited company. The reason for this is that they can extract the profits by way of dividends which do not suffer National Insurance as would be the case for an employee. When introduced, it was expected that it would raise significant amounts of revenue. In reality it has raised very little tax.

New Risk Based Approach

In an attempt to try to introduce some clarity on the application of IR35 and to target their resources, HM Revenue & Customs (HMRC) are implementing a risk based approach to decide which businesses to investigate in detail to see whether or not IR35 applies to a business. Guidance has been issued on how this risk will be assessed and HMRC have started to issue IR35 compliance letters to companies they have identified as potentially within the scope of IR35.

The Scorecard

In order to determine which risk band applies to a business, 12 questions relating to the way that your business is operated must been answered. These questions are designed so that for 11 of the questions, a "yes" suggest that IR35 doesn't apply and awards between 1 and 35 points for that answer (different questions are worth different numbers of points). A "yes" answer to the 12th question (Have you worked under PAYE for your client in the last 12 months?) scores minus 15 points.

The more points you score in total, the lower the risk. HMRC have said that they will band businesses as low risk if they have more than 20 points, medium risk if they have 10-20 points and high risk if they have less than 10 points.

It is important to note that these results only indicate to HMRC the risk that IR35 may apply. They do not change the law (which is largely based on Tax Cases) nor that mean that IR35 actually does or does not apply.

"HMRC's new risk based approach to IR35 is an attempt to provide some clarity to businesses and for HMRC to target their enquiries more closely on those businesses which may be caught by IR35." **Alan Ross, Tax Director**

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Applying the Tests

HMRC suggest that businesses should apply the tests and retain evidence of their application of the tests, which they can then produce in the event of an enquiry. Whilst the guidance doesn't say as much, it may also help to mitigate penalties in the event that there is a successful challenge by HMRC. The guidance provides details on the evidence which should be retained in support of the answer to a particular test.

Since circumstances may change, the tests should be taken again on a change in circumstances and again the evidence should be retained.

What are the Practical Implications?

If HMRC think that IR35 may apply to your business (which may simply be because they know you have a one-man company), they will write to you. If you can demonstrate to them that either IR35 clearly doesn't apply, or that you fall in the low risk category their guidance confirms that they will close their enquiry and not contact you again for 3 years.

If you fall in the medium risk category, this means there is a medium risk of HMRC checking whether or not IR35 applies (i.e. having established your risk category they may or may not proceed to undertake a detailed review). If you fall in the high risk category, there is a high risk of a review (i.e. it is most likely that they will do a detailed review). This review will make a detailed assessment on an engagement by engagement basis to see whether or not IR35 applies.

What Next?

It is not compulsory to take the tests, however by taking the tests now and on each occasion when your circumstances change, you will have evidence to support your position in the event of an enquiry by HMRC. This may reduce the penalties charged if it is ultimately concluded that IR35 does apply.

For £600 (+VAT) Wilson Partners will prepare your risk assessment and will also review an existing client contract for the risk of IR35 actually applying.

If you receive an IR35 compliance letter, you should seek immediate advice on how to respond with a view to demonstrating why IR35 should not be applied.

"If you get it wrong and don't apply IR35 when it should apply, the costs to settle matters with HMRC could be substantial."

Alan Ross, Tax Director

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