

IR35 revisited

Are any of your clients affected by IR35? If so, the AAT would like to hear from you to add to our feedback to HMRC following their publication on 9 May 2012 of their business entity tests and risk bands – please email your comments to consultation@aat.org.uk by **30 September 2012**.

The purpose of this article is to summarise the guidance and ask for your reaction to the proposals.

Background

The Office of Tax Simplification (OTS) reported to the Chancellor in March 2011 commenting on client stress and distraction

“of cases settled in 2009/10 or 2010/11, almost half took over 142 weeks to complete, and approximately one in five lasted for more than four years. This is clearly very stressful for the taxpayer, who wants to concentrate on his business.”

There is also the cost to HMRC.

The Government’s reaction to the OTS report was to announce at the 2011 Budget its intention to retain IR35, but to introduce improvements in the way it is administered. HMRC published its new approach in May 2012 which can be read at: hmrc.gov.uk/ir35/guidance.pdf

HMRC “guidance” announces the confidential IR35 “**Advice helpline and Review**” service on 0845 303 3535. As well as answering one-off queries, the IR35 helpline provides a review service, staffed by HMRC specialists in IR35, independent of the compliance teams. The specialists will review a contract to provide their opinion on the IR35 position offering a degree of certainty to the extent that if they conclude that a contract is outside IR35, they will give a certificate, with a unique number, valid for three years.

Example scenarios (not reproduced here) are given in the guidance to illustrate when and why IR35 will apply to an engagement.

12 Business entity tests and risk bands are published. ‘High risk’ means a greater chance of an IR35 review than those in the medium or low risk bands.

Test scores and risk bands

Less than 10	High risk
10 to 20	Medium risk
More than 20	Low risk

Business Premises test Use of business premises separate from home or client’s premises	10 points if answer is yes. Evidence: Lease/contract, utility bills
The PII test Professional indemnity insurance required	2 points if answer is yes

<p>Efficiency test</p> <p>Opportunity over last 24 months to increase business income by working more efficiently, e.g. by finishing a fixed-price contract early, enabling the business to take on new business</p>	<p>10 points if answer is yes</p> <p>Evidence: Clauses in the contract Copies of proposals/tenders, clients' letters accepting offers</p>
<p>Assistance test</p> <p>Do engaged workers (not directors/shareholders) bring in at least 25% of turnover</p>	<p>35 points if answer is yes</p> <p>Evidence: Records, details of workers</p>
<p>Advertising test</p> <p>Over £1,200 spent on advertising in the last 12 months</p>	<p>2 points if answer is yes</p> <p>Evidence: Advertising invoices.</p>
<p>Previous PAYE test</p> <p>Engaged by current end client on PAYE employment terms within past 12 months; no major changes to working arrangements</p>	<p>Minus 15 points if answer is yes</p> <p>Engagement by current client on PAYE</p>
<p>Business Plan test (two parts)</p> <p>Part 1 - Regularly updated business plan/cash flow forecast</p> <p>Part 2 - Business bank account</p>	<p>1 point if answer to both questions is yes</p> <p>Evidence: Copy of business plan & updates</p> <p>Business bank account statements</p>
<p>Repair at Own Expense test</p> <p>Business to bear cost to rectify mistakes</p>	<p>4 points if answer is yes</p> <p>Evidence: Clause in contract. Details of mistakes. Cost to business of rectifying mistakes</p>
<p>Client Risk test</p> <p>Business unable to recover payment for work done in the last 24 months, more than 10% of yearly turnover</p>	<p>10 points if answer is yes</p> <p>Evidence: Accounting records showing write-offs, copies of reminders, legal action for recovery</p>

<p>Billing test</p> <p>Invoice for work carried out before being paid Negotiation of payment terms</p>	<p>2 points if answer is yes</p> <p>Evidence: Copies of invoices/billings</p>
<p>Right of Substitution test</p> <p>Does business have right to send a substitute?</p>	<p>2 points if answer is yes</p> <p>Evidence : Clause in contract as to who would supply substitute, who would be responsible for the substitute's performance and pay</p>
<p>Actual Substitution test</p> <p>Engaged anyone in the last 24 months for work taken on by business, either by sending someone to do the work in the place of the proprietor or by sub-contracting</p>	<p>20 points if answer is yes</p> <p>Evidence: Details of who was hired. Business to remain responsible for work and paying employee or subcontractor</p> <p>Audit trail of payments</p>

Comment: HMRC's warns "if you use an intermediary, but work for an end client on terms which would have made you an employee if the end client had engaged you directly, then IR35 will apply."

This seems reasonable, but the above risk rules have been heavily criticised as being unrealistic in practice with most points going for business premises, use of sub-contractors or employees, and bad debts over 10%.

In today's uncertain market it might well be a prudent commercial decision for a new business to trade from home, rather than hire premises and to be careful in engaging workers.

It is reasonable for a business to be efficient and strictly manage bad debts to be as low as possible. It is therefore odd to give greater credibility to businesses that may be more inefficient and have bad debts exceeding 10% of turnover.

On the other hand, few points are given for normal small business features such as PII, business bank account and business plans. Also, a number of cases have been won before Tribunals as not being within IR35, but which would be regarded as high risk on HMRC risk scoring.

Please note: The purpose of the legislation - sections 48 - 61, Income Tax (Earnings & Pensions) Act 2003, and mirrored in the Social Security Contributions (Intermediaries) Regulations - SI 2000/727 - is to counter situations where tax on employment income is reduced through the use of a company (or other intermediary) and is directed at each contract or arrangement rather than the overall business of the company.

Please email your comments to consultation@aat.org.uk by **30 September 2012**.

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