

EXTRACT FROM THE 2012 HMRC GUIDANCE ON IR35

Chapter 4: The business entity tests

The tests

We have drawn up the business entity tests to help you find out which risk band you are in.

The tests are completely voluntary – we will not make you take them. If you do take them, you do not have to tell us which risk band you are in.

The business entity tests need to build up a good picture of how your business works and, in particular, how you provide your services.

There are twelve of them.

- Business premises
- PII
- Efficiency
- Assistance
- Advertising
- Previous PAYE
- Business plan
- Repair at own expense
- Client risk
- Billing
- Right of substitution
- Actual substitution

Each test asks at least one question. A Yes answer scores points. Different tests give different scores. You add up the points at the end. The business entity tests look at a business as a whole to gauge how likely it is that the business has entered into an engagement to which IR35 applies.

But they do not focus on individual engagements. Therefore, the example scenarios in Chapters 5 to 11 have no bearing on the business entity tests.

Test scores and risk bands

This table tells you which risk band you are in.

Total score from the tests Risk band

Less than 10 High risk

10 to 20 Medium risk

More than 20 Low risk

15 Evidence to support your answers

You will be able to answer the test questions from your knowledge of your own business. If you find that you are in the 'low risk' band, you need to gather and retain enough relevant and reliable evidence about your business as a whole to prove to our satisfaction that you are in the 'low risk' band.

You need to do this when you take the tests. You may find it harder to gather the evidence when some time has passed.

We will not open an IR35 review until after the tax year has ended. You can take the tests looking back over a period if you wish. But, if you do not take the tests for a tax year until – some time afterwards – we open an IR35 review into that year, you may find it harder to gather the evidence to support your answers.

What counts as enough relevant and reliable evidence will of course depend on the facts of the case.

With each test, we have given examples of the kind of evidence you could use to show that you have passed it. But these are examples, not requirements. We will be willing to accept other evidence if it is satisfactory.

Taking the tests again

Suppose your circumstances change, with the result that you may have moved out of the 'low risk' band. Then you need to take the business entity tests again and, if necessary, gather and retain new evidence.

Otherwise, you may find it harder to prove to our satisfaction that you are still in the 'low risk' band.

Or suppose your circumstances change, with the result that you may have moved into the 'low risk' band. Then you need to take the business entity tests again and, if necessary, gather and retain new evidence. Otherwise, you may be in the 'low risk' band without knowing it or being able to prove it.

The Business Premises test

Test

Does your business own or rent business premises which are separate both from your home and from the end client's premises?

For the purposes of this test, it makes no difference which of you owns or rents the business premises – you yourself or your intermediary.

Evidence

- Address of business premises
- Lease or contract for business premises
- Utility bills for business premises
- Home address
- Client's address

Score

Score 10 points if your answer is Yes.

The PII test

Test

Do you need professional indemnity insurance?

Evidence

- PII policy document
- PII premium note
- Explanation why you need PII

Score

Score 2 points if your answer is Yes.

The Efficiency test

Test

Has your business had the opportunity in the last 24 months to increase your business income by working more efficiently?

One way of doing this is finishing a fixed-price contract early. Say you agreed with the end client that the work would take three months and the fee would be £10,000. And say you finished in two months and received the full £10,000 at that point. You would have freed up a month to take on new business. So the answer to this question would be Yes.

Evidence

Clauses in the contract. Here are some examples.

- You receive a fixed payment on completion.
- You crystallise the profit when you make the supply of services to the end client.
- You can provide extra workers to complete the job more quickly.
- Copies of:
 - Costings for proposals
 - Tenders submitted
 - Letters from clients accepting offers.

These would show the proposal options and related costs that you submitted for clients to approve and accept.

Score

Score 10 points if your answer is Yes.

The Assistance test

Test

Does your business engage any workers who bring in at least 25% of your yearly turnover?

If your intermediary is a company, these workers need to be people other than directors or shareholders of the company.

If your intermediary is a partnership, these workers need to be people other than partners in the partnership.

Evidence

- Accounting records
- Details of tasks carried out
- Names and payment details of workers who carried them out

Score

Score 35 points if your answer is Yes.

The Advertising test

Test

Has your business spent over £1,200 on advertising in the last 12 months?

Entertainment does not count as advertising.

Evidence

- Copy of advertisement(s) placed
- Copy of invoice(s)

Score

Score 2 points if your answer is Yes.

The Previous PAYE test

Test

Has the current end client engaged you:

- on PAYE employment terms
- within the 12 months which ended on the last 31 March
- with no major changes to your working arrangements?

If you are doing the same work, the answer to this question is Yes.

Working at a different location does not count as a major change.

If you were working for a company that is connected to the current end client, that counts as working for the current end client. For example, if the two companies are part of the same group.

Evidence

We will be able to check your employment history on our systems.

Score

Score Minus 15 points if your answer is Yes.

The Business Plan test

Test

This test has two parts.

Does your business have a business plan with a cash flow forecast which you update regularly?

Does your business have a business bank account, identified as such by the bank, which is separate from your personal account?

Evidence

- Copy of business plan
- Copies of updates
- Statements of business bank account

Score

Score 1 point if your answer to both questions is Yes.

The Repair At Own Expense test

Test

Would your business have to bear the cost of having to put right any mistakes?

Evidence

- Clause in contract
- Details of what could go wrong
- Details of how you would put it right
- Details of the cost to your business of putting mistakes right

Score

Score 4 points if your answer is Yes.

The Client Risk test

Test

Has your business been unable to recover payment:

- for work done in the last 24 months
- more than 10% of yearly turnover?
- Evidence
- Accounting records showing write-offs
- Copies of letters and emails between intermediary and end client
- Copies of letters and emails about legal action for recovery

Score

Score 10 points if your answer is Yes.

The Billing test

Test

Do you invoice for work carried out before being paid and negotiate payment terms?

- Evidence
- Copies of invoices
- Copies of letters and emails about billing

Score

Score 2 points if your answer is Yes.

The Right of Substitution test

Test

Does your business have the right to send a substitute?

Evidence

- Clause in contract
- Details of who would supply the substitute
- Details of who would be responsible for the substitute's performance
- Details of who would pay the substitute
- Details of what level of veto the end client has

Score

Score 2 points if your answer is Yes.

The Actual Substitution test

Test

Have you hired anyone in the last 24 months to do the work you have taken on?

You could do this by sending someone to do the work in your place. You could also do this by sub-contracting.

But your business has to remain responsible for the work and for paying the person who does the work you have taken on.

You can still pass this test if you had to tell your end client the name of the person who would be doing the work you took on.

Evidence

- Details of end client
- Details of who was hired
- Details of why the substitute was hired
- Details of who was responsible for finding the substitute
- Details of who was responsible for paying the substitute
- Payment terms
- Audit trail of payment from end client to intermediary and from intermediary to substitute

Score : Score 20 points if your answer is Yes.