



What to do in an IR35 investigation

HMRC use sophisticated software to analyse public sector databases and highlight discrepancies which are then used to target sectors identified as being at risk of non-compliance. In this guide, we look at ways of reducing the risk of being non-compliant, and what to do in an investigation.

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What to do in an IR35 investigation

When asked to comment on what factors might trigger an IR35 investigation, HMRC's official response was, "Any individual who provides his/her services through a service company to an end client potentially falls within IR35." Such a broad remit places limited company contractors at constant risk of non-compliance, not least because IR35 legislation applies to each separate contract.



While HMRC remain vague on the precise means of determining who is investigated, sophisticated software makes it possible for HMRC to analyse public sector databases, highlighting discrepancies which are then used to target sectors identified as being at risk of non-compliance. This means that by the time HMRC contacts you, they will already have background knowledge of your company and its recent trading activity. It doesn't always follow that HMRC will launch a full investigation, especially if they are able to quickly establish that your limited company is compliant. In this article, we look at what to expect in the event of an IR35 investigation and some of the ways you can reduce the risk of being found non-compliant.

What happens when HMRC contacts you?

- 1.** In the first instance, HMRC may approach the contractor to arrange an Employer Compliance Visit. Contractors should be aware that they are under no legal obligation to meet with HMRC face-to-face; in most cases it is best to insist on written interaction, which will give you chance to prepare. If an officer requests to visit your business premises, then written notice should be given. Limited resources mean that HMRC will increasingly dispense with compliance visits and move straight onto step two.
- 2.** Although no meeting is currently required, HMRC does have statutory powers to inspect PAYE records, so these must be made available. HMRC will request copies of contract(s) for the current and previous tax year. Upon review, The Compliance Officer may refer to IR35 and request further information or documentation, which will be passed onto a Status Inspector.
- 3.** The Status Inspector may seek to obtain more information, including details of the contractor's working practices, particularly from third parties such as the agency (if one is involved) and the end client. The inspector will use this information to try to establish the true nature of the contractor's relationship with the client, applying the key concepts of Control, Mutuality of Obligation and Right of Substitution to determine if they are a 'disguised employee.'
- 4.** If HMRC believe that the contractor is a disguised employee, then they will raise Regulation 80 Determinations (for Tax) and a Section 8 Notice (for NIC) using the deemed calculation (the calculation of what tax is owed). An appeal can be made against the Determinations and Notices within 30 days, with a request for the collection of the additional duties to be postponed pending resolution.

How to reduce the risk of IR35 investigations

In many instances, contractors can reduce the risk of getting caught inside IR35 by keeping their paperwork in good order and being aware of discrepancies that could act as a red flag for HMRC. A genuine limited company contractor will find their own customers, risk their own capital, purchase materials, and potentially have their own premises. HMRC are looking for corroborating evidence of this in the company's paperwork.



Exercising reasonable care

Since 2009, HMRC introduced the concept that taxpayers must exercise reasonable care in dealing with their tax affairs. In many cases, this could be interpreted as the contractor seeking to clarify the terms of their engagement with the end client and to make these terms clear in their records. The following precautions are good examples of taking reasonable care

1. Use the status tool on HMRC's website and keep a printout of the results. The tool is not perfect, for example, it does not cover 'Mutuality of Obligation,' but does indicate that you have considered the issue.
2. Contractors should rigorously file RTI submissions and answer the questions honestly.
3. Ask for a right of substitution clause to be incorporated into your contract and other clauses that relate to your working practice – keep copies of these negotiations, even if you're not successful in obtaining your requests.
4. If you're using an agency, check that the higher-level contract between the agency and the client mirrors the lower level contract between you (the contractor) and the agency.
5. Write a confirmation of arrangement letter asking the end client to confirm and clarify the terms of your engagement. A letter signed by the end client that demonstrates the contractor's independence from the company is a valuable piece of evidence in an IR35 investigation.
6. Keep thorough records, including details of substitutes you used or could have used, mileage logs and expense payments, evidence of financial risk such as contracts that were terminated prematurely and periods without work. If you use an agency, you can also use your timesheet to indicate that you are self-employed.

7. Consider having your contracts reviewed by an IR35 professional; this is increasingly necessary given the complexity in determining compliancy and the fact that, since 2011, contractors can be outside IR35 for one period of a contract and, if the nature of the assignment changes, inside IR35 for another period. Be aware that using HMRC's contract review service could inadvertently place you on their radar.
8. Consider taking out IR35 insurance to cover the cost of representation in an investigation plus the potential cost of paying back unpaid taxes and penalties. You will need to do this before you receive a letter from HMRC.
9. Consider using a compliant umbrella company if you think your contract is inside.

Under investigation

When HMRC makes contact with you, it's important not to panic and make mistakes that could be used against you later. Many people feel under pressure to comply with any request, fearing that failure to do so will be seen as guilty or obstructive behaviour. While it's best to be polite and helpful, it's also essential to know your rights so that you can be prepared for HMRC's questions. With this in mind, take the following actions if contacted:

- Do not panic
- Never agree to anything that you are unhappy with, without first thinking about it
- Be helpful and respond to requests in a timely manner
- Politely refuse face-to-face meetings and insist on written interaction
- Contact your accountant to acquire the correct paperwork
- Contact your insurance provider to check what level of cover you have
- Insist upon assessing any third party information obtained by HMRC and correct anything you feel is misrepresentative

What happens if you're caught by IR35?

If you're found to be within IR35 you can expect to pay around 25% more in tax. HMRC can also go back up to 20 years to assess liability and apply penalties, depending on the nature of their findings. Usually, they will go back 4 years, and sometimes 6 years.

HMRC differentiates between non-compliance based upon behaviours. Carelessness results in a 6-year time limit and a penalty of up to 30% of any unpaid tax or NIC. Contractors who they believe knew they were inside IR35 but deliberately chose not to make the deemed calculation incur a penalty of up to 70% of the additional liability within a 20-year time limit. Where HMRC can show that the position was deliberately concealed the penalty is up to 100% of the additional liability.



To talk to a member of our team call 0203 642 8679 or request a free call back.

