

Contractors face escalated IR35 threat as HMRC starts flexing new Schedule 36 powers

Contractors confident that their [IR35 defence](#) would stand up to HMRC's scrutiny in an [IR35 investigation](#) will need to rethink once new powers of investigation under [Schedule 36](#) become widely used by tax inspectors.

Although the powers available under Schedule 36 have been available to HMRC since April 2009, inspectors have been undergoing rigorous training in the new regulations before rolling them out, according to Matt Boddington, director at IR35 specialists [Accountax](#).

"Schedule 36 brings together in one place a range of tax legislation and significantly broadens HMRC's investigatory powers," explains Boddington. "We believe that HMRC is about to start using their new powers in [IR35](#) investigations, which will have a significant impact on contractors."

HMRC can compel clients to give evidence

So what's so scary about Schedule 36? According to Boddington, alongside the widely publicised powers of entry and the increased penalties, HMRC also has sweeping new powers to obtain information from third parties.

"Under the previous rules, inspectors could ask a third party, like a contractor's end-user client, to provide information in an IR35 investigation. And, whilst they could cajole, pressure and bully a response, they could not actually compel. That's now changed."

The new rules allow an inspector the legal power to issue a notice that a client must provide information about the contractor. "In theory, there are safeguards and the new rules say either the taxpayer must give their permission for the third party to provide information or the inspector requires agreement from a tribunal. But in practice" warns Boddington, "I believe HMRC will simply approach end-users and tell them that unless they comply with HMRC's demands they will face a legal order from the Tribunal. In these circumstances most end-users will feel they have no option but to comply. HMRC may not even notify the contractor that this has happened."

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Matt Boddington, Accountax

Not only is this a disturbing new weapon in HMRC's armoury, the potential for HMRC to stride in and cause damage to contractor's relationships with end-user clients is horrifying.

HMRC to make the facts fit their IR35 case

What also worries Boddington and his colleagues at Accountax is what they view as HMRC's tendency to try to fit facts supplied by the contractor and client to its preconceived ideas about the [contractor's IR35 status](#). Boddington warns this could be exacerbated by another little known power buried deep in the schedule.

"Rules designed to protect the taxpayer require the inspector to disclose the enquiry they are making to the third party, but only if they apply for a formal order from the Tribunal," he explains. "However, HMRC can keep the third party's response from the contractor and their professional advisers."

This alarming aspect of the new tax laws means that HMRC can claim facts about the contractors working practices, which could potentially put them inside of IR35, without having to reveal the evidence to the contractor or their defence team unless the matter comes before the Tax Tribunal and HMRC are ordered to disclose it. This potentially leaves contractors under investigation without the ability to challenge the evidence against them unless they take their case to the independent Tax Tribunal, which is a costly and time-consuming process.

Contractor IR35 defence strategies

"A successful IR35 defence is not about winning: it's about avoiding a case in the first place," explains Boddington. "HMRC have given themselves a whole new array of powers and penalties, which they are itching to try out on taxpayers they have targeted for maximum 'yield' and it is no secret that HMRC are hostile to the contracting sector."

Fortunately, plenty can be done to avoid an IR35 investigation in the first place. "Contractors don't have to spend a lot of money to make huge improvements in their IR35 position," he continues. "Minor amendments resulting from a contract review by a specialist would make it difficult for HMRC to target a contractor."

For peace of mind, many contractors invest in [IR35 tax investigation insurance](#), which is available through membership of organisations like the [Professional Contractors Group](#), or can be purchased as standalone policies.

Contractor safeguards

Boddington is highly sceptical about the protection the taxpayer safeguards included in Schedule 36 will actually provide to those who find themselves the subject of an investigation. And he is particularly worried that contractors cannot appeal against HMRC being given permission by a Tribunal to request information from third parties.

"I can see extensive questionnaires going to third parties, like contractors' former clients. These are likely to include leading questions designed to elicit a certain answer because of the way they are phrased," he says. "HMRC has always asked such questions, but the difference now is that they can demand an answer, which the contractor is not allowed to see, and the only way to fight this approach is to haul the client as a witness in front of a court and cross examine them."

Investigation activity by HMRC is likely to increase significantly as inspectors learn how best to apply their new powers, and contractors who take on board an 'avoidance' strategy – and that's avoiding investigations rather than tax! – are less likely to be on the receiving end of an investigation.

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