

## Tough IR35 crackdown by HMRC is imminent, warns former tax inspector

IR35 is likely to be high on HMRC's agenda this autumn as, following a lull of 18 months, [limited company contractors](#) will once more be in the firing line, warns former HMRC manager and IR35 expert Kate Cottrell of [Bauer & Cottrell](#).

"HMRC has its sights firmly set on limited company contractors," she says. "The latest set of questions on contractor tax paperwork provides it with a target-rich environment, which it will no doubt exploit.

"Many are at risk," she warns. "My fear for contractors is that the last 18 months of low levels of HMRC activity on IR35 have been the calm before the storm, and that we will see limited company contractors increasingly under the spotlight as the Treasury seeks to raise taxes.

Cottrell also seeks to dampen the expectations of contractors assuming that a potential change of government will see the end of IR35: "Because of the huge sums of tax raised indirectly as a result of IR35, for example by [umbrella companies](#) and limited company contractors inside IR35 making their deemed payments, IR35 is likely to be here to stay."

### IR35's contribution to the exchequer

"The [results](#) of the [Freedom of Information Act](#) request by the Professional Contractors Group ([PCG](#)), which seemed to indicate a pitiful tax take from IR35, are misleading," says Cottrell. "For example, HMRC did not have systems in place to identify where tax revenues came from for much of IR35's existence.

"However, it is clear that, if not for IR35, many umbrella companies would not exist," she continues. "That's important to remember in the 'scrap IR35' debate, because compliant umbrella companies are highly efficient tax gatherers on behalf of the Treasury." Despite this, however, the Treasury has [targeted the umbrella sector](#) and challenged players in the market to be rigorously compliant.

### Contractors unprepared for IR35 onslaught?

Cottrell, who used to manage a team of inspectors in her former life with HMRC, fears that many limited company contractors know too little about IR35, are unprepared for an [IR35 inspection](#) and could find themselves on the receiving end of a nasty tax bill.

"Many contractors assume that a [substitution clause](#) puts them firmly outside IR35, but this is most certainly not the case," continues Cottrell. "The biggest factor, particularly since the [Dragonfly IR35 ruling](#), which did contractors no favours, is [control](#)."

She says that HMRC will be looking at the 'what', 'where', 'when' and 'how' of every contract: Post Dragonfly, the emphasis is on the 'what' – whether a client controls the contractor and can say, or simply has the right to say, 'stop doing that and now go and do this', and whether they are monitored and checked."

She says: "Contractors can ensure that an investigation is quick and painless by [getting their contracts checked](#) and asking their client for a [confirmation of arrangements](#). Plus, it is essential to have expert representation who can deal with HMRC on a contractor's behalf."

### Employer Compliance Reviews

"In the event of an investigation, it is sensible to expect an inspector to be looking into your IR35 status as this is where the potential yield lies," says Cottrell. "When that happens, limited company contractors are likely to receive notice of an Employer Compliance Review (ECR), which is the most common route for IR35 cases to start. The letter is not random and HMRC has specifically targeted the contractor because of something being flagged in their tax records by HMRC's risk and research teams."

HMRC will ask to see a representative of the company, usually the contractor, and try to arrange a meeting. Since April 2009, HMRC has wide ranging new powers for inspections and information requests which extend to the right to make unannounced visits to business premises.

Typically when investigating IR35 they will bombard the contractor with hundreds of questions about what they do and precisely how they work. The end-user client will also be questioned.

"Contractors are making a mistake if they attempt to field HMRC questions by themselves," says Cottrell: "They are frequently unprepared and don't understand the significance of the questions asked or the answers given. Contractors should always request questions in writing or at the very least a detailed written agenda prior to any meeting."

“ Contractors can ensure that an investigation is quick and painless by getting their contracts checked and asking their client for a confirmation of arrangements ”

Kate Cottrell, Bauer & Cottrell

## IR35 status no longer a grey area

After ten years of IR35, managing the risks of the legislation is not as hard as it once was. The grey areas are often the result of the lack of knowledge of all parties in the contractual chain from the end client to the contractors themselves. "Not only are there contractors who don't understand IR35," Cottrell comments, "but there are also contractors who don't even know about IR35!"

She says that there also remains a legacy of the former [managed services companies](#) (MSCs) some of which did not take IR35 seriously. Many advised their contractor clients that they were working outside of IR35, and many contractors still rely on this opinion several years later. Cottrell says that some people are now many contracts further down the line, but are still working through the same provider, albeit rebadged as an accountancy services provider.

But all contractors working through their own limited companies should be prepared. "HMRC has told us how much they are spending on compliance work, and we are seeing real evidence of joined-up government in initiatives, such as the [Agency Workers Directive](#) and proposed [Construction Industry Scheme](#). Contractors who do not take action to clearly establish their status and make provision could find themselves in receipt of a very unwelcome visit from an inspector."

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