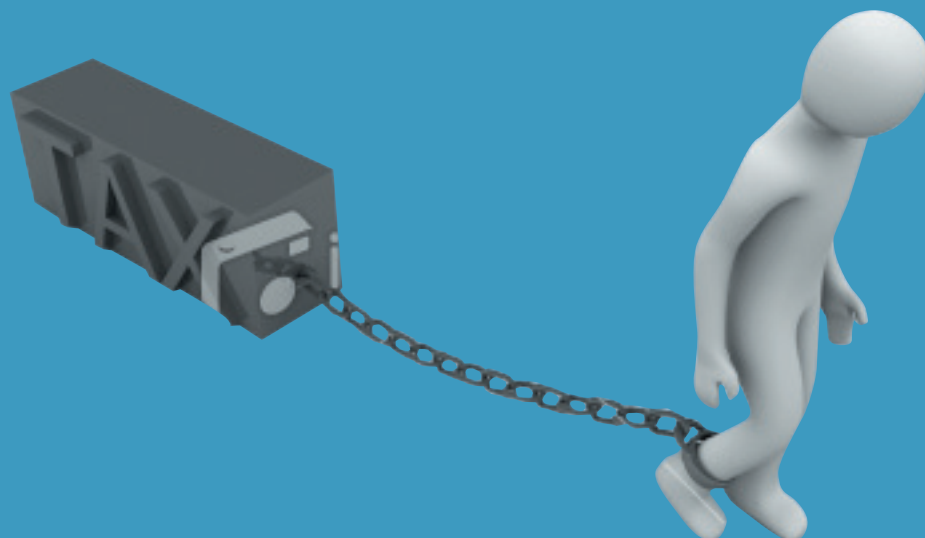




# IR35: Better administration or enforcement?

## ContractorCalculator White Paper

- IR35 will remain in force for the foreseeable future
- Contractors have been promised better administration
- HMRC is driving reform via the IR35 Forum
- Any reforms must be tax revenue neutral
- The number of contractors is increasing
- Better administration means better enforcement



# Contents

---

Foreword ..... 3

Analysing the objectives for IR35’s better administration ..... 5

Targeting strategies to segment contractors into IR35 risk bands..... 8

Better administration of IR35 – so what does that actually mean?..... 15

‘In-business’ tests are a great idea in theory, not in practice..... 18

How to measure whether IR35 really is being better administered..... 21

Conclusion – IR35 Forum – what’s the best we can expect? ..... 23

About the Author – Dave Chaplin of ContractorCalculator ..... 25

---

© 2011 ContractorCalculator. All rights reserved.  
Duplication in part or whole is strictly prohibited except under the provisions of fair use.

ContractorCalculator, a trading name and imprint of  
Byte-Vision Ltd  
112C Roman Road  
Basingstoke  
Hampshire RG23 8HE

Tel: 0871 218 5152  
Email: office@contractorcalculator.co.uk  
Web: www.contractorcalculator.co.uk

# Dave Chaplin, ContractorCalculator

---

IR35 will remain in force for the foreseeable future. That's the unavoidable conclusion following Chancellor George Osborne's decision not to abolish or repeal IR35 in his 2011 Budget. His caveat was the promise of 'better administration' of the legislation by HMRC. This has led to the creation of a new body, the IR35 Forum, which might play a role in securing a fairer deal for the UK's flexible workforce. There are two inevitable conclusions:

- The contracting sector must accept, for the foreseeable future, that the original IR35 legislation and case law remains unchanged. So, for now, 'better administration' by HMRC is the only solution to improve the lives of genuine contractors
- It is an inescapable reality that a country in such desperate need of tax revenues is hardly going to introduce measures that will result in lower tax yields, so 'better administration' will mean 'better enforcement' of IR35.

HMRC is notorious for its lack of self evaluation and its intransigence in the face of criticism. Even promises of improvement forced out of senior managers following highly critical reports about its past and current performance by the Treasury Commons Select Committee<sup>1</sup> and the National Audit Office (NAO)<sup>2</sup> were grudging. And the tax gathering organisation that is so keen to examine the intimate details of taxpayers' lives only just started monitoring its implementation of IR35 in any meaningful way from April 2010.

On that basis, what hope is there that the non-HMRC members of the IR35 Forum can convince HMRC that, first, it is at fault and, second, it needs to take meaningful remedial action?

But there is hope. Principally, all concerned should realise that the objectives of contractors, HMRC and the Treasury may not be so different after all. Once the details of what actually constitutes better administration of IR35 and its objectives are more clearly understood, as we examine in chapter 1, the Forum can start to chart a course towards that 'better' destination. Contractors want fairness and certainty, and so does the Chancellor in terms of tax yields.

HMRC has revealed during the first two meetings of the IR35 Forum that it plans to segment contractors into three risk bands – low, medium and high. Those in the low and medium bands will receive targeted support. Those in the high risk category will undergo targeted compliance activity by HMRC's IR35 experts, who will be properly trained in how to apply the legislation. This would put the needs of contractors alongside those of HMRC, for fairer, consistent and expert application of the law, as we discover in chapter 2. But sadly, despite its protestations and promises to do better, HMRC has even at this early stage reverted to form, and refused to share its risk criteria with contractors and their advisors. That ongoing uncertainty will put contractors back where they were; and that's not progress.

Also worrying is the IR35 Forum's ominous obsession with 'in-business' or 'gateway tests', as we discuss in chapter 4. The objective of the Office of Tax Simplification's original research into IR35, and its alternatives, was to simplify. Adding a new set of tests to the existing tests of employment, which are already fiendishly complex, is not simplification. Where similar tests have been introduced, as in Australia, contractors have not benefitted. Quite the opposite, in fact.

---

Without some form of measurement or benchmarking, the whole exercise becomes meaningless. What will 'better administration' look like and what performance criteria can be applied to ensure HMRC and the contracting sector are moving in the same direction? In chapter 5, we show how measuring 'better administration' could actually be of benefit to contractors, HMRC and the Treasury. But the IR35 Forum has a key role to play in ensuring that HMRC's performance is not just monitored according to meaningful criteria, but is corrected if targets are not met.

What we can conclude from our analysis is that 'better administration' does indeed mean 'better enforcement'. We can also conclude that better enforcement of IR35 may not be such a bad thing for contractors and the contracting sector, as long as it also leads to certainty and consistency.

However, judging by the progress made by the IR35 Forum to date (which appears to be very little), there is much to do. The non-HMRC members of the IR35 Forum must step up the intensity of engagement and take greater control of proceedings, lest HMRC be handed the gift of sweeping new processes that damage the livelihoods of genuine contractors and the contracting sector as a whole.

And in all of this, let's not forget the bigger picture: that the UK's knowledge economy relies on highly skilled and highly flexible contractors. Anything that could persuade contractors and their clients that the UK is not a good place in which to do business, will ultimately slow the recovery of the UK economy in the short term, and do severe damage to UK Plc in the long term.

*Dave Chaplin* London, August 2011

# Analysing the objectives for IR35's better administration

---

Contractors must now accept that, following the 2011 Budget, IR35 will not be abolished for the foreseeable future. Indeed, as the flexible workforce (and potential 'disguised employees') increases as a percentage of the UK's economically active population, the scope for abuse of the system and for tax avoidance is increasing. In other words, there is an argument, particularly amongst those responsible for the UK's revenue, that retaining IR35 is not only necessary, but even desirable.

Now that HMRC and the Treasury accept that there is a case for a reform of IR35's administration, and the IR35 Forum has been tasked to offer solutions to do just that, there is a slim possibility that IR35 could become fairer and more workable.

## IR35 stands accused of systemically failing contractors

Certainly, following the work of the Office of Tax Simplification and the subsequent Budget in early 2011, there can be no doubt that IR35 fails systemically to perform as it should. Due to its in-built failures of process and application, it fails dismally at its most basic task – to tackle the avoidance of disguised employment.

And, more seriously, it fails on a more strategic level, in that it takes no account of the fact that the world has moved on considerably since IR35's inception over ten years ago. Indeed, even when it was first mooted in 1999, IR35 was already trying to use industrial age concepts to tackle knowledge economy issues.

## The only certainty IR35 offers is uncertainty, at every level

The principles of workable taxation require that tax law should contain certainty and leave no room for ambiguity, as a result being clearly understood and enforceable. Unfortunately, IR35 fails on all those counts, as HMRC has demonstrated time and again through over a decade of inconsistent targeting and application.

Because IR35 was so badly designed at the outset, HMRC has struggled to enforce it, repeatedly applying the rules to contractors who were clearly never meant to be within scope, and losing the majority of its cases as a result. Perhaps more seriously, it has also lost the 'hearts and minds' of contractors. That's because, in order to avoid HMRC's erratic approach, many contractors have opted to use trading vehicles that mean they must pay far more tax than they have to, whilst simultaneously watching obvious disguised employees getting away with it.



*There is an argument, particularly amongst those responsible for the UK's revenue, that retaining IR35 is not only necessary, but even desirable*

---

The reasons for IR35's systemic failure to fulfil the criteria as 'good tax law' are many, but largely come down to the fact that no tax can be workable if it is:

- Misunderstood by taxpayers
- Misunderstood by HMRC, the very organisation responsible for its enforcement
- Ambiguous and lacking in certainty
- So complex it can only be 'understood' by experts with conflicting interpretations
- Only enforceable piecemeal, one taxpayer at a time
- Inconsistently applied
- Easy to evade and where breaking the rules cannot be easily detected and investigated
- Dependent on the taxpayer to decide whether it should apply.

Clearly, the objectives for better administration of IR35 should start at the very least with resolving the above issues. However, these are largely systemic issues; should the IR35 Forum dig deeper when considering how to better administer IR35, and question the whole basis of the rationale on which IR35 is founded?

## Industrial age concepts applied to tax avoidance in the knowledge economy

False contractors (or disguised employees) typically avoid the full taxes that should arise from employment by using an intermediary such as a limited company. That's an accepted fact, and there is therefore a strong argument there should be legislation to address such workers. It could effectively distinguish genuine contractors from disguised employees, by dealing once and for all with the 'Friday to Monday', 'perm-tractor' and other false contractors who are, in effect, employees who should be taxed as such.

But, as has been repeatedly demonstrated by HMRC's attempts to apply IR35 to genuine contractors, at times it is very difficult to tell the genuine contractors from the disguised employees. Should an engineering consultant genuinely in business be penalised because things like airports and chemical plants take a long time to build? Equally, leaving work on Friday, only to start on Monday doing exactly the same job, at the same desk and for the same 'boss', but as a consultant, looks highly suspicious and, in many cases, really is a case of disguised employment.

When determining to whom anti-avoidance legislation should apply, this brings us back to the question: what was the original intention of IR35? Who did the Treasury and HMRC wish to target? And what is the situation now; is the intention to target any and all flexible workers because:

- a) Many more workers are choosing flexible working
- b) Our economy is increasingly dependent on flexible workers to compete globally
- c) HMRC fears that more flexible workers will result in lower tax yields?

---

HMRC offered profiles<sup>3</sup> of the kind of flexible workers that IR35 was intended to target – view ‘Gordon’, ‘Henry’ and ‘Charlotte’ for more details – and ten years later these highlight why IR35 has become such mess – the profiles are vague, don’t relate to current case law and appear to focus mainly on IT contractors.

## A recipe for better administration of IR35

As did the Office of Tax Simplification before it, the IR35 Forum faces the challenges of trying to find a workable solution to the administration of IR35 without changes to the original legislation, and all whilst maintaining tax yields. In addition, any potential solutions the IR35 Forum puts forward and are accepted by government may face potential intransigence from an HMRC that is widely acknowledged to be under-staffed and under huge pressure.

However, the minutes from the IR35 Forum’s first two meetings show that it is no closer to determining the type of avoidance it aims to target. Yet that is essential to building a profile of the individuals that the legislation was and should be designed to target. Understanding who you are setting out to catch is the only way to create workable guidance and rules that will catch the right people and leave the innocent free to focus their energies working to support the UK economy.

HMRC, on the other hand, is making no secret of the fact that its operational strategy will segment contractors into three risk bands – low, medium and high. But the organisation is being typically secretive about the risk criteria it plans to apply, which means no progress from the contracting sector’s perspective. Without this information, contractors and their advisers remain in the dark and will have to try and second-guess how to remain within the law, rather than being shown how to.

The next step will be to create clear rules and definitive guidance for HMRC’s inspectors on whom to target and how. These rules and the guidance must also remain within the boundaries of the source legislation, which will be no mean feat if they are to make sense when applied to flexible workers in the 21st Century’s challenging, fast-moving and global knowledge economy.

# Targeting strategies to segment contractors into IR35 risk bands

---

The minutes of the first two meetings of the IR35 Forum revealed that HMRC is already well advanced in developing a strategy that segments contractors into broad bands according to their IR35 risk.

But HMRC is planning to apply these 'high', 'medium' and 'low' risk categories to contractors without actually telling contractors and their advisers what the risk criteria actually are. Nor has it yet indicated what sampling methodologies it plans to adopt to sift through the estimated 1.4m flexible workers in the UK and identify those worthy of inspection.

So just how does HMRC intend to tell disguised employees from genuine contractors? The blurring of boundaries between the two categories can make it very difficult indeed. After all, the ECR Consulting case clearly shows how genuine contractors and employees can, to all outwards appearances, appear to be doing exactly the same job. Yet, as the final ruling confirmed, one is legitimately a contractor in business and the other is an employee.

## A contracting insider's view on what constitutes a high risk contractor

Experienced contractors will be familiar with the three categories of contractor who most contracting sector insiders would acknowledge as being 'disguised employees' at high risk of falling foul of IR35:

- **'Permtractors'** – these workers start on a genuine project, but contract extension follows contract extension, until they find themselves part of the furniture, staying for years, sometimes decades, yet never officially joining the client's workforce as an employee.
- **'Tail-end Charlies'** – these workers are so-called because they are told by the client to take all the left-over work at the tail-end of projects, or pick up bits and bobs from other contractor's or employees' workloads. So, unlike a genuine contractor, they don't focus on a contract-specific project with a set of clearly defined deliverables
- **The 'Friday to Monday mob'** – these are usually highly paid senior employees who leave employment on a Friday, only to return on Monday to do the same job, often at the same desk, as a 'consultant' working through their own limited company.

So, what might be the lessons for the taxman? Well, HMRC could start segmenting contractors by publicly stating that they might be inside IR35: if they work for the same client for more than a set period; or they are not contracted on a specific project; or they have previously been employed by the client doing the same or a very similar role.

To better target these individuals, HMRC could develop questions on the P35, or on other tax forms, to identify: how long a contractor has worked for a client; if the project has specific deliverables; and whether the contractor was previously employed by the client in a similar role.

*Genuine contractors and employees can, to all outwards appearances, appear to be doing exactly the same job*



---

However, as the ECR Consulting ruling has demonstrated, things are rarely that simple: scratch the surface of what appears to be an obvious disguised employee and the true story may be quite different.

## Situations are often not what they seem

After segmenting 'high risk' contractors based on questions on the P35, HMRC might consider that it has created a target-rich environment for IR35 investigations that will generate a good yield in unpaid income tax, National Insurance Contributions (NICs), fines and interest.

But, in all likelihood, the taxman may find on further investigation that:

- Many contractors, particularly those in engineering, can spend several years on a project simply because big things like chemical plants and airports take a long time to build
- Some freelancers are hired as 'trouble-shooters' to help employees cope when times are busy, or simply to clean-up loose ends – their 'project' is to work across multiple projects and clean up other people's messes
- And many contractors and consultants start their freelance career by working for their former employer, simply because they know the organisation extremely well and it's the first contract they're able to win as a first-timer, or they have been made redundant but have been asked to complete a project or handover on a consulting basis.

Are any of the above types of contractor any less likely to be in business on their own account simply because of the peculiarities of their current assignment? And, more importantly, should contractors be penalised by paying more tax because their current assignment is lasting a long time, involves working on multiple projects, or is with a former employer?

## Can the level of 'control' be used as a segmentation strategy?

IR35-savvy contractors increasingly understand that control is one of the key tests of employment applied by HMRC to determine whether a contractor is really a disguised employee who should be taxed accordingly.

But can a segmentation strategy based on control work for HMRC in today's knowledge economy? The ECR Consulting ruling demonstrated that it is unlikely that a very highly qualified and skilled individual working on a contract can be deemed to be controlled. Of course a contractor expects to receive some direction from the client about project objectives and deliverables, but that does not constitute control over how to perform the tasks required to meet those objectives.

---

And the contracting sector knows how hard it is to prove control of a knowledge worker, meaning HMRC is increasingly likely to come up against well planned IR35 defences. Segmenting contractors into a high risk category on the basis that they are controlled is likely to leave HMRC with increasingly fewer targets.

## Are there any workable IR35-risk segmentation strategies for HMRC?

So what new processes could HMRC adopt to catch more disguised employees? Specifically, what processes can segment high risk contractors (ie likely disguised employees) without netting a significant number of medium and low risk genuine contractors? And of these processes, which can HMRC effectively resource?

Is a blanket rule, such as 'guilty unless certified' the only solution, whereby an independent, and possibly commercial, body/bodies 'audits' each contractor and provides an 'outside IR35' certificate for each contract? Could simple rules for the high risk categories of 'permtractors', 'Friday to Monday mob' and 'tail-end Charlies' be combined with such a certification scheme?

Or are 'in business' or 'gateway' tests the solution? HMRC is investigating these as part of its remit on the IR35 Forum, and confirmed in the second meeting of the Forum that the project is very much still a 'work in progress'. But business tests can't possibly offer a fair verdict on all flexible workers, as has been discussed in ContractorCalculator's IR35 Solutions white paper<sup>4</sup>, and as has been resoundingly proven by the Australian Personal Services Income (PSI) model<sup>5</sup>.

And then, of course, there's the overarching question: is any attempt by the contracting sector to offer workable IR35-risk segmentation options doomed to failure if HMRC refuses to share its IR35 risk criteria with the very community of taxpayers, agents and advisers it is planning to target?

# Better administration of IR35 – so what does that actually mean?

---

In its 2011 Budget document, the government committed to making “clear improvements to the way IR35 is administered”. Specifically, its commitments included:

- “Publishing guidance on those types of cases HMRC views as outside the scope of IR35”
- “Targeting compliance activity by restricting reviews to high risk cases”  
and
- “Setting up an IR35 Forum that will monitor HMRC’s new approach.”

Already the minutes of the first two IR35 Forum meetings have offered insights into what HMRC views as better administration of IR35. And HMRC’s better administration is shaping up not to be “clear improvements” at all, from a contracting perspective.

The taxman’s opening gambit is that better administration “was intended to be construed in the widest sense of the word”. This should set alarm bells ringing as to whether HMRC’s view is that “better administration” simply means “tougher enforcement”.

## Better administration won’t mean better legislation, but better processes

IR35 has not been repealed. The legislation remains in force in its original badly constructed, botched and muddled form. Contractors caught by IR35 must still pay the price of paying tax as if they were employed, but without enjoying any of the benefits and protections offered by employment law.

The case law developed over the last ten years will also continue to apply, and the lessons learned from, and legal precedents set by, cases like Dragonfly, Larkstar and Novosoft all remain in place.

So the only route to clear improvements in the administration of IR35 will be process improvements. If those lead to catching the blatant cases, such as the ‘Friday to Monday mob’, the permtractors and ‘tail-end Charlies’, and leaves the borderline cases alone, then that’s a positive step for the contracting sector.

But new processes that actually widen the net and catch or seriously inconvenience genuine contractors will be a regressive step. That will be particularly true if the processes form part of a broader strategy to impose a heavier tax burden on the flexible workforce.

*IR35 has not been repealed, so the only route to clear improvements in the administration of IR35 will be process improvements*

---

## The “clear improvements” sought by contractors

If the IR35 Forum is to succeed in its task of monitoring HMRC’s new approach, then clear improvements in guidance and process must be the result. Specifically, contractors need to be able to:

- Understand the risk criteria HMRC will apply to segment contractors into being at high, medium or low risk of being inside IR35. If contractors understand those criteria, a minority may apply them to attempt to evade tax. The majority will understand and accept their status because the alternative is to break the law.
- Believe and trust that HMRC will apply the risk criteria consistently, that there will be no ‘inspector lottery’ and that the mavericks of years gone by, who from outward appearances appeared to delight in tormenting contractors, will themselves understand and stick to the rules.
- Understand the inspection and tribunal process, and that the process has a time limit. Tribunals should be fast-tracked so contractors won’t spend several years uncertain of their tax status. More than one contractor has stopped their defence campaign, citing ‘family reasons’. The contractor in the recent Primary Path case spent eight years under the cloud of HMRC’s botched investigation and still achieved a convincing win. It doesn’t take a rocket scientist to deduce that in some cases this probably means stress and a fear of haemorrhaging money in defence fees. Equally, though, contractors should understand that if they wilfully delay the process then they will be punished, and quite rightly so.
- Believe that they can expect certainty in their tax affairs and fair treatment by HMRC.

The above, to a contractor or any other businessperson, is mainly common sense. But HMRC has very few decision makers who have ever done anything other than be tax inspectors, so the tax authority should be offered these kinds of insights by other members of the IR35 Forum, to help it put better processes into place.

## Renewed and meaningful guidance

Accompanying the risk criteria and improvements in process must be renewed and meaningful guidance. Existing guidance is so broad as to be meaningless, potentially branding virtually all contractors as tax evaders and inside IR35, when this is clearly not the case.

There must also be room for interpretation, and that’s why the UK has such an effective and, on the whole, fair legal system. For example, the guidance might say that individuals who left a former employer on a Friday and started work as a consultant on the Monday doing the same work at the same desk may be considered as disguised employees.

What would be of great value to contractors would be if the guidance went on to qualify this by suggesting that if the same individual then remained in that position for several years without seeking alternative contracts or doing anything that remotely resembled running a business, then they would almost certainly be disguised employees. That way, contractors would know where they stand.

---

## What if “better administration” simply turns out to mean “tougher enforcement”?

It took ten years, but ultimately HMRC lost the first battle over IR35. The contracting sector, and its expert advisers, got so wise to HMRC’s tactics that the number of cases has slowed to a trickle.

But the country desperately needs tax revenues, and limited company contractors, particularly where spouses share the income, are perceived as being a major contributor to the ‘tax gap’. And the IR35 Forum could well end up providing HMRC with loads of really useful market data about how contractors and contracting works, and how so many contractors have managed to avoid IR35 to date.

What contractors really want to happen is that HMRC will think: “Let’s give the taxpaying public much better guidance, so they will truly know if they are caught by IR35 or not, so they can plan for their taxes much better. Let’s also make it clear that we are only interested in going after tax evaders.”

Unfortunately, what may actually happen is that HMRC will think: “Let’s get our IR35 house in order and make sure we catch and tax to the hilt all those vulnerable, unrepresented one-person and husband-and-wife limited companies.”

# 'In-business' tests are a great idea in theory, not in practice

---

Contractors are complex animals whose varied working practices can't be reduced to simple tick boxes on an 'in-business' test. Where such tests have been tried, the results have not been positive, as the Australian example proves.

But, as the minutes of the inaugural IR35 Forum meeting show, HMRC has been asked to create a "gateway test model"; at the second meeting it was confirmed that the project was ongoing. The idea of 'in-business' tests was originally included in the Office of Tax Simplification's interim report on its Small Business Tax Review<sup>6</sup>.

HMRC and Treasury chiefs must be delighted with that Forum decision. A set of simple 'in-business' tests that were defined by tax inspectors, and had the blessing of contracting sector representatives on the Forum, would be a perfect solution to better administer IR35.

But that's unlikely to be a good thing for contractors, as it would make it so much easier for the taxman to categorise vast swathes of contractors as disguised employees and tax them accordingly.

Fortunately, it seems some on the Forum have already flagged that such apparently simple "gateway tests" might not be quite so simple in practice. The minutes of the Forum's first meeting reported that "there were some concerns about how such a test would in fact operate in practice".

## If a simple test was workable, wouldn't it be in place already?

The UK's legal system has benefitted from centuries of fine legal minds being applied to create a code of laws that, by and large, work rather well. Leading judges have contributed to a body of legislation through case law that has been applied to determining employment status for decades.

So, if a simple set of 'in-business' tests could be made to work, wouldn't it have been developed and be in place by now?

An objective test might look superficially to be a simple undertaking, but the contracting sector knows from hard-won experience that it's just not possible. And the ContractorCalculator team has first-hand experience, having spent months working alongside IR35 experts Qdos Consulting to develop our IR35 Online Test<sup>7</sup>.

We had a team, including former tax inspectors, employment law experts and masters level mathematicians, analysing case law and working on algorithms that could be used to determine a contractor's IR35 status.

*If a simple set of 'in-business' tests could be made to work, wouldn't it have been developed and be in place by now?*

---

Could we achieve our aim of a 'simple' test? Well, it's simple to take our online test, but such are the complexities of IR35 legislation and case law that it takes over 50 questions to determine a contractor's IR35 status. Even then, it's on an 11-point scale ranging from 'fail', to 'borderline fail', through 'borderline', to 'borderline pass' and then 'pass'.

So believe this team of industry and IR35 experts when it assures you that there is no such thing as a simple 'in-business' test.

### An objective test would catch too many innocent, genuine contractors

The elegance of the common law concept that underpins the UK's legal system is that it is open to interpretation. Some might consider that flexibility to be a curse, but a set of rules that does not acknowledge that the real world is a complex place, with shades of grey, won't remain in place for long.

Australia's Personal Services Income (PSI) rules are a prime example of how such inflexible business tests have seriously backfired on the contracting community. There is no flexibility and the tests are quite arbitrary. For example, why should a contractor with 80% of their income from a single client in a given year be any less 'in business' than a contractor with 79% of their income from a single client?

In order to catch contractors who really are, and should be taxed as, employees, the line would have to be drawn so far back that a huge number of genuine contractors would cross it. This could happen, for example, just by virtue of a contractor having a client's project overrun, meaning that 'too large' a percentage of their income in a financial year is from a single client.

### Who watches the watchers?

By allowing HMRC to drive the development of 'in-business' tests, or to use HMRC's terminology, 'gateway' tests, is akin to offering a child the keys to a sweet shop. Of course HMRC will come up with a set of rules that will be designed to catch as many contractors as possible – it would not be doing its job properly, and representing taxpayers' interests, if it did not!

But what is particularly frightening about the current scenario is that HMRC will have created these 'gateway' tests with the contracting sector's tacit approval, by virtue of the trade and membership bodies representing contractors on the IR35 Forum.

If the contracting sector is not careful, HMRC will be able to unleash its own gateway tests on contractors. And the contracting sector will have no come-back, as HMRC would be likely simply to point out that the tests were developed with (or even by) the contracting sector itself.

It is incumbent upon those non-HMRC members of the IR35 Forum to veto the idea of 'in-business' tests as unworkable now, before the idea gains too much momentum, and HMRC feels it has the mandate it requires.

# How to measure whether IR35 really is being better administered

---

Whilst contractors and the contracting community broadly welcome the intention to ‘better administer IR35’, there remains what appears to be an almost unanswerable question: “Better than what, precisely?”.

HMRC admitted during the second meeting of the IR35 Forum that it has in the past “adopted less refined selection criteria than used now”. But without historical data, how is it possible to measure the “refinement” of targeting strategies, except perhaps indirectly, through the misery of those contractors caught by HMRC’s lack of refinement?

When HMRC and the Office of Tax Simplification were tasked with reviewing IR35, there was a requirement for any changes to be “revenue neutral”. That’s political-speak for “Don’t make any changes that will lose the Treasury any existing tax income.”

And, of course, only the most optimistic of contractors would think anything else but that what the Treasury really meant was, “However you choose to administer IR35, make sure you use the legislation to extract more tax out of contractors than you’ve previously been able to.”

At the heart of both these statements is the understanding that the one element that won’t change is the legislation itself. IR35 remains on the statute book and the legislation, plus the case law supporting it, remains unchanged. The only thing that may change is how HMRC chooses to administer IR35, which is where the IR35 Forum comes in.

But how will we know if any changes that are introduced meet the Treasury’s aims of making “clear improvements to the way IR35 is administered”? The only way to know for certain is to benchmark and measure performance, so it is essential that the IR35 Forum insists that is done.

## No benchmark or historical data

HMRC has already proven itself adept at not monitoring its own performance when it comes to IR35. In response to a Freedom of Information Act request by ContractorCalculator, it admitted that it does not hold the kind of data that would facilitate an analysis of the first ten years of IR35’s administration<sup>8</sup>.

Indeed, recording the amount of time spent by individual officers on specific cases only began in April 2010. That means that it is simply not possible to calculate how much it has cost taxpayers to administer IR35 in its current form. Therefore, producing a benchmark cannot be done.

Compounding the lack of hard data held by HMRC is the behavioural impact of changing the way IR35 is administered. For example, whilst it is reasonable to speculate that the popularity of umbrellas in the early noughties stemmed from the introduction and rigorous enforcement of IR35 at that time, it is not possible to be definitive.

*The only thing that may change is how HMRC chooses to administer IR35, which is where the IR35 Forum comes in*



---

And how should the huge sums of Pay As You Earn (PAYE) income tax and National Insurance Contributions (NICs) collected by umbrella companies be classified? As yield from IR35, or simply put in the general employment taxes pot?

## Introducing measurement processes

So, because of HMRC's lack of metrics, a clear benchmark cannot be drawn. So how might the IR35 Forum help put in place processes that could be used to measure whether any new system is doing a better job of administering IR35 than what has gone before? Here are a few suggestions:

- Taking some measurements now – it might be necessary to conduct customer [taxpayer] research for this to be effective and to gain insights into the behavioural impact of what HMRC is doing now, and has done in the past
- Create a benchmark, and a snapshot of what customers perceive to be good, neutral and bad about the current situation
- Make the changes developed in the IR35 Forum
- Regularly take the same measurements, including basic items such as tax yield, costs of implementation and administration, and further customer research
- Analyse the data to determine whether any of the changes in IR35's administration have impacted on the measurables
- Review process changes, then reverse, enhance or adapt them as required, based on the information coming from the metrics and analysis.

For the measurement results to be meaningful, a year's worth of data is probably the minimum period over which any measurement trials should take place. It therefore follows that any changes adopted (whether or not they come about in response to IR35 Forum proposals) should be in place for at least a year.

Clearly the measurement and analysis would have benefits for HMRC and the Treasury. They will be able to track changes in tax yields and changes in the costs to administer IR35. Increased yield and lower costs, together with customer perceptions that the process was administered better and more fairly, would be the desired result.

## Without measurement, changes to IR35's administration would be meaningless

If HMRC and the Treasury are serious about improving the administration of IR35, and improving the experience contractors have of the process, it must put transparent measurement processes into place.

Should the work of the IR35 Forum lead to revised guidance without proposing new processes to gauge its effectiveness, then in reality HMRC will only be paying lip-service to the Treasury's desire to see "clear improvements to the way IR35 is administered".

---

HMRC is starting to monitor some aspects of its administration of IR35 by recording the details of calls to the IR35 helpline. However, simply recording the date and time of the call and the topic discussed does not offer any insights into whether HMRC is actually improving its service to taxpayers. More significantly, it doesn't provide any indication as to whether it is administering IR35 any better.

The IR35 Forum has a unique opportunity to create a tax regime that offers the fairness and certainty contractors and their agents require. At the same time, the Forum can not only support the Treasury's need to maintain or increase tax yields, but can also help strengthen the foundations of the UK's essential knowledge economy.

Devising and adopting new measurement processes is a vital element of that process, and there is further work for the Forum to complete in this area.

# IR35 Forum – what's the best we can expect?

---

IR35 will be better administered, we've been assured. But we've not been told what that actually means. So in the absence of any evidence to the contrary, we have to assume that 'better administered' means 'better enforced'.

This raises two further issues: firstly, is it right to assume that 'better administered' does indeed mean 'better enforced'; and secondly, if that is the case, are things likely to get better or worse for genuine contractors?

When tasked by the Chancellor's 2011 Budget with identifying better administration methods, the IR35 Forum and, more specifically, its HMRC representatives, were given guidance that any solutions must be revenue neutral. So, the overall tax take has to remain at the same level as it was at the time of the budget. Which, to be simplistic, means that no contractor should be feeling hopeful about paying less tax in future as a result of the IR35 Forum's work.

Let's throw something else into the mix. A number of recent labour market surveys are in agreement that ever-more workers are choosing flexible working, freelancing and contracting over employment. So, to maintain the same levels of tax yield, HMRC will actually have to step up its enforcement to catch the greater number of disguised employees that are likely to arise as a result of the ever-expanding pool of flexible workers.

So whichever way you look at it, contractors should be readying themselves for better enforcement of IR35, and more of it. And early indications from the IR35 Forum appear to back this up. For example, HMRC's opening gambit at the very first meeting of the IR35 Forum was to make it plain that the taxman is planning to classify flexible workers into risk bands.

But, against the spirit of openness many expected the Forum to engender, HMRC refused to offer any guidance on just what criteria they might apply. And it has maintained this position through the second meeting of the Forum, emphasising its need to keep its new IR35 operational strategy confidential.

Would such guidance have provided useful anyway? Some of the UK's best taxation minds, both within and without HMRC, have been focusing on IR35 for over a decade. Yet its implementation is a shambles. You only have to look at the details of HMRC's most recent defeats to convince you of this: the ECR Consulting, Marlen and Primary Path cases should never have been pursued beyond the earliest investigation stages; yet between them have taken many years of painful investigation before they were all thrown out at tribunal.

Others are pinning their hopes for the 'better administration of IR35' on the use of gateway, or 'in-business' tests. But such tests have many potential pitfalls, as Australian contractors have found to their cost (literally) after similar tests were introduced there. If they were introduced in the UK, they could leave the majority of contractors worse off than they are now. And no matter how much pain the 'in-business' tests caused, HMRC wouldn't need to budge; even if criticised by legislators it could simply claim the tests were introduced with the contracting sector's blessing, via the IR35 Forum.

*No contractor should be feeling hopeful about paying less tax in future as a result of the IR35 Forum's work*

---

But don't despair, there are some glimmers of hope, albeit somewhat buried away in the Office of Tax Simplification's interim Small Business Taxation Review (Table C.3)<sup>10</sup>; in the 2011 Budget document (paragraph 2.203)<sup>11</sup>; and in the minutes of the first two IR35 Forum meetings<sup>12</sup>.

HMRC has revealed that it is planning to create an IR35 National Compliance Unit and IR35 Compliance teams. These will be staffed by IR35 experts who will tackle only high risk cases, with clear guidance for inspectors and/or a strict code of practice. What's not to like about that option? Why would that be a bad thing for genuine contractors? Expert application of clearly understood risk criteria and implementation of the rules by specialists would be a definite step in the right direction

Obvious high risk cases would be targeted by HMRC's IR35 specialists, including 'Friday to Monday' workers, 'tail-end-charlies' and 'permtractors'. At the same time, detailed guidance and a code of conduct would prevent cases lasting years and give grounds for appeal by contractors facing over-zealous inspectors. The risk of misinterpretation by HMRC seen in the ECR and Primary Path cases, where inspectors only saw workers who superficially had 'disguised employment' characteristics, would be reduced through better training and clear understanding of the legislation.

More importantly, genuine contractors would be left to do what they do best, finding solutions that ultimately strengthen UK Plc.

IR35 will not be abolished. In fact, something like it is likely to remain with us until there is a root and branch reform of UK tax laws, including a merger of National Insurance Contributions (NICs) and income tax. So perhaps better enforcement might be the best we can hope for. But only if it's the right sort of better enforcement, which is fairer, clearer and only targets disguised employees, not genuine contractors.

# Dave Chaplin of ContractorCalculator

---

ContractorCalculator is the UK's leading website for contractors and freelancers.

It has been online and independent since 1999, when it launched [ir35calc.co.uk](http://ir35calc.co.uk) to help contractors count the cost of the then newly released IR35 legislation.

Still owned by founder and former IT contractor Dave Chaplin, the site has grown dramatically since then to become the expert guide to contracting. Dave is still actively involved in its management, supported by a dedicated team of contractors and freelancers.

ContractorCalculator's ABC-audited monthly audience of over 130,000 regular readers is made up of contractors, freelancers, interims and consultants from the IT, telecoms, engineering, oil, gas and energy, business, marketing and medical sectors. They keep coming back as the site offers:

- A comprehensive range of essential online financial, salary and tax calculators
- A high quality daily news service from a professional editorial team
- Expert commentary and analysis from industry and sector leaders
- More than 1,000 online articles and guides suitable for beginners and veterans
- Access to leading contractor services.

As a result of this fantastic resource for those new to contracting and experienced old-hands, ContractorCalculator has been dubbed 'The Expert Guide to Contracting'. It is also the publisher of the definitive guide to UK contracting –

**The Contractors' Handbook: the expert guide for UK contractors and freelancers**

---

## Dave Chaplin

When IR35 was first announced in 1999, contractors and freelancers had no idea about the massive impact it was to have on their livelihoods. Until, that is, ContractorCalculator founder and CEO Dave Chaplin – who is also a mathematician and at that time was a leading IT contractor – wrote and published online the first ever interactive IR35 calculator.

As a result of Dave's pioneering work, when the shocking truth emerged about the financial impact of IR35 on legitimate contractors' earnings, the contracting and freelancing sector was never to be the same again.

And while still working as an IT contractor for blue chip clients in London's financial district, Dave built the first contractors' and freelancers' portal, including high quality news and in-depth guides, around a range of online financial calculators that became ContractorCalculator.

Dave's passion for ensuring that today's contractors and freelancers are equipped to flourish prompted him to write the contracting sector's definitive guide – **The Contractors' Handbook: the expert guide for UK contractors and freelancers.**

By 2004 Dave was working full time on the website and has since created a team comprising business and financial journalists, marketers and web designers, all experienced and highly qualified contractors and freelancers. These ongoing developments mean the site is produced by contractors and for contractors, with Dave as its CEO and Editor in Chief.

# Contact us

---

## ContractorCalculator Press Office

Please direct media enquiries to Dave Chaplin on 0871 218 5152  
or email **dave.chaplin@contractorcalculator.co.uk**

## General enquiries

Please call **0871 218 5152** or email **office@contractorcalculator.co.uk**

ContractorCalculator, a trading name of  
Byte-Vision Ltd  
112C Roman Road  
Basingstoke  
Hampshire RG23 8HE