

How to avoid an IR35 investigation

Contractors seeking to avoid being targeted for an **IR35 investigation** by HMRC can adopt a range of strategies that will help reduce the likelihood of their being targeted for a review.

"**IR35 best practice** together with the factors highlighted by HMRC's **business entity tests** (BETs) can provide contractors with a framework to reduce the risk of being investigated by the taxman," explains **Qdos Consulting's** IR35 expert **Andy Vessey**.

The good news, according to Vessey, is that classic contractor behaviours, such as paying a **low salary and high dividend**, are unlikely to lead to an investigation. HMRC's specialist IR35 teams, and not local offices, determine who to investigate and why.

However, he warns contractors, particularly high earners, that HMRC is on the lookout for opportunities to generate a good yield from their compliance activity, so they should focus on filing tax paperwork correctly and on time.

Clues from the now defunct business entity tests (BETs)

The BETs were abolished in April 2015, but they were originally designed as a tool to enable HMRC to evaluate IR35 risk. For this reason, Vessey believes that, although they are no longer in force, the BETs provide valuable insights into HMRC's risk profiling.

"When they were in force between May 2012 and April 2015, the BETs by themselves did not determine whether a contractor was caught by IR35, but they do provide contractors with insights into what strategies can be used to avoid an IR35 investigation," continues Vessey.

He urges contractors who can do so to **substitute** at least once every three years, and to consider other activities that would have scored highly with the BETs, such as hiring office space. He acknowledges that, "For many contractors it is simply not practical for them to send a substitute because, their clients generally don't want or understand the need for a substitute.

Another option is to be able to demonstrate that they fix errors in their own time, which not only used to lead to a low BETs score but is also a pointer towards financial risk, a positive factor for IR35: "All a contractor needs is an email from their project manager asking them to fix something, and to show that when they fixed it, the time was not billed to the client," he adds.

Contractors who received a low risk BETs score and were awarded a reference number from HMRC confirming that they would not be investigated for a further three years have been assured that the taxman will continue to honour this guarantee for the full term even after the BETs were abolished in April 2015.

Making mistakes and late filing attract attention

A guaranteed way to get on HMRC's radar is to submit tax paperwork late and/or with errors. Vessey explains: "An inspector will work on the principle that if a contractor has made mistakes with, for example, their corporation tax return, they are probably making other mistakes that could lead to an incorrect tax calculation.

"Contractors should take such simple steps as hiring an accountant to file their tax returns and other tax paperwork. And they should do what they can to avoid making a 'generalist' tax inspector think IR35 might apply. Although major HMRC offices such as Cardiff handle things like tax returns, they will refer a contractor's case to a central specialist IR35 team if they believe that IR35 could apply."

Accounts analysis

Because HMRC uses a range of sophisticated software to analyse all the data available on individual taxpayers, contractors may be at risk of being investigated without even realising it.

"HMRC has dedicated teams that use data mining and analysis to flag potential targets for investigation," says Vessey. "So, if a contractor is particularly profitable one year and much less so the next, HMRC's software will spot this and flag the case for a human tax inspector to review."

Contractors may be able to avoid this type of investigation simply by including explanatory notes on their tax return: "HMRC will actually accept a reasonable explanation as to why expenses might be particularly high when compared to previous years, which could nip a potential IR35 investigation in the bud."

IR35 best practice

Vessey emphasises that there is no substitute for good, old-fashioned IR35 best practice: "Contractors should begin each contract with a contract dossier that will start with the expert contract review commissioned before accepting the contract and a **confirmation of arrangements** signed by the contractor's

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client.

"It will then include all the emails and meeting notes that point to the contractor being outside IR35. Ideally, it will also include an example of a substitution."

A contractor should be able to produce a dossier for each contract. That way, if they are investigated by HMRC, the professional adviser paid for by their [tax investigation insurance](#) has all the ammunition needed to quickly shut down an investigation, or to persuade the taxman not to pursue it.

Beware of 'grasses' - be nice to your partners/spouse/business associates

Interestingly, Vessey notes that some reviews are started as a result of anonymous tip-offs to HMRC: "Contractors won't be 'shopped' directly because of their IR35 status, but what we have seen are disgruntled ex-spouses, partners and business associates calling HMRC, often because the contractor has boasted about how little tax they pay."



Andy Vessey

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Andy is a Senior Tax professional at Qdos and has a wealth of experience in IR35 and status matters which he guides the firm on.

Qdos Consulting is a leading expert in status and IR35. The company also consults in taxation and employment law and provides low cost business insurance for contractors. [Read Full Profile...](#)

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Although tip-offs identifying contractors are not that common, Vessey suggests that contractors should be very careful who they speak to about their business and tax affairs and try to avoid giving away too much information to anyone other than those who can be totally trusted.

Vessey concludes: "It takes remarkably little effort for contractors to adopt IR35 investigation-avoiding strategies. But the effort is well worthwhile if it results in killing an investigation before it gets off the ground."

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