

What triggers an HMRC IR35 investigation?

Contractors can trigger an [IR35 investigation by HMRC](#) as a result of working in a particular sector, because of the work of HMRC's Transparent Benchmarking team, or though exhibiting behaviours that makes HMRC suspicious of your IR35 status. HMRC are constantly monitoring businesses and use this data to refine their risk profiling and [IR35](#) targeting.

"The triggers of an IR35 review can be either direct, because a contractor meets HMRC's IR35 risk criteria, or indirect, as a result of another investigation, such as into corporation tax, VAT or payroll," explains [Qdos Consulting's](#) IR35 expert [Andy Vessey](#).

"And with four specialist IR35 teams at HMRC focusing specifically on contractors, contractors should take appropriate measures to avoid IR35 investigations," he warns.

HMRC has gathered together all of its IR35 guidance and links to online resources into a single document, [Intermediaries Legislation \(IR35\) - Working through an intermediary, such as a Personal Service Company](#), published in June 2014.

HMRC's IR35 sector campaigns

According to Vessey, one of the key criteria guiding HMRC's IR35 investigation targeting is the sector in which a contractor works. And sectoral risk assessment and targeting are not just restricted to contractors.

"Investigation teams targets sectors its risk profiling teams identify as being at high risk of non-compliance with HMRC IR35 rules," he says. "Campaigns have included doctors, dentists, teachers and trainers, and health professions such as physiotherapists, as well as restaurants in London and haulage firms in the Midlands." Simply put, no one is off limited when it comes to HMRC's hunt for IR35 offenders, so beware!

Vessey also notes that specific sectors can also be targeted for IR35 investigations as a result of media pressure on HMRC that leads to Government action. Contractors in the public sector came under the spotlight as a result of the [off-payroll rules](#) and the Treasury investigation that preceded them.

"Public sector organisations were required to identify off-payroll workers working for them, which in effect meant contractors. This highly specific information about contractors working in the public sector was passed to HMRC so they could review their IR35 status. In this case the taxman used this data to conduct hundreds of investigations into these contractors."

“HMRC has adopted a strategy of targeting sectors its risk profiling teams have identified as being at high risk of non-compliance activity”

Andy Vessey, Qdos Consulting

Data mining and analysis by HMRC to detect IR35 non-compliance

Vessey highlights that the days of the random IR35 inspection by HMRC are over: "Once, local tax inspectors might open a certain number of random inspections on their patch into corporation tax, VAT or Pay As You Earn (PAYE) income tax, and these had the potential to catch contractors.

"Those days are long gone, because HMRC lacks the resources and there are much more efficient methods of targeting possible IR35 offenders now available. HMRC's risk assessment is conducted at a regional and national level using hugely sophisticated software able to analyse all public sector databases and identify discrepancies."

Vessey warns that contractors who have filed incorrect information or different types of tax paperwork that do not tally will almost certainly be flagged by the software for an inspector to review their file and make a decision on whether to have a HMRC inspector investigate their IR35 status. A contractor business with wildly fluctuating profits or expenses may also cause HMRC to look closer.

Don't give HMRC a reason to think you might be breaking IR35 rules

"Contractors should maintain high quality and accurate business records and use the services of a professional to ensure their information is filed correctly. Otherwise they could be inviting a HMRC tax inspector to come and investigate their IR35 status and other tax affairs," Vessey continues.

"If there are exceptional figures in the accounts and tax return, such as dramatic increases or falls in sales profits or expenses, contractors should include a note in the supplementary section of the corporation tax return explaining the reasons for the change. This may convince an inspector to pass over their business for review."

In Vessey's experience, if an inspector's attention is caught by another aspect of a contractor's tax, such as corporation tax, VAT or PAYE, once the taxman knows they are dealing with a contractor it almost invariably ends up being referred to an HMRC's IR35 specialist team.

Real time information (RTI) and the service company question

In addition to business records held on online databases that HMRC data mines, contractors should ensure they file accurate and timely real time information (RTI) submissions and accurately answer the personal services company question on their tax returns.

"Although RTI means that contractors will no longer file a P35 with the service company question, they will have the same question to answer at the time of their final return for a tax year under RTI and on their and personal self assessment tax return," explains Vessey.

"Despite tax barrister Keith Gordon's [successful campaign](#) to prove that contractors cannot be compelled to answer the service company question, in practice contractors should be honest and fill it in. Failing to complete the question simply places further doubt in an inspector's mind and could be the trigger for an IR35 investigation by HMRC."

Vessey adds that although the P35 has gone, contractors still have RTI and should rigorously file submissions: "If a contractor consistently fails to get RTI right, the taxman immediately wonders what else the contractor is getting wrong, so they shoot up the inspector's risk profile rating."

The Transparent Benchmarking Team

HMRC has a team that focuses its efforts on working out average financial performance ratios of different types of businesses based on the huge amount of data it has collated from corporation tax returns, personal self assessment tax returns and the returns filed by sole traders.

The team has profiled some trades and professions, such as driving instructors and painters and decorators, with a view to identifying the average profitability of businesses in these areas. It is likely that businesses such as 'IT consultants' and 'engineering consultants' are on this team's hit list.

If so, contractors who are showing profits and business costs and expenses that are significantly different may start to receive letters asking them why they vary from the benchmarks of their type of business established by the team.

IR35 contract review service and anonymous tip-offs

Vessey urges contractors not to use HMRC's IR35 contract review service because he believes it acts as a source of leads for the four central compliance teams: "HMRC's IR35 helpline could either be the prevention or trigger of an enquiry. If the contractor's contract is outside IR35, then HMRC promises not to investigate for three years.

"And of course HMRC promises that callers' details are not passed onto IR35 inspector colleagues. But those high risk contractors using the service face an even greater risk. If an HMRC officer reviews a contractor's contract and finds it places the contractor at high risk of being inside IR35, of course they are going to forward the details to their IR35 colleagues. I certainly don't trust them not to."



[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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Interestingly, Vessey identifies a final trigger for IR35 investigations by HMRC: tip-offs. "Disgruntled spouses or partners have been known to anonymously tip-off HMRC about their spouse/partner's financial affairs.

"Ordinarily an anonymous tip-off would start as an income tax or corporation tax investigation, but once the inspector knows a contractor is involved, they will call in the specialist IR35 units."

Updated: Monday, April 6, 2015

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