

IR35 Business Entity Test for contractors – process and questions



Note that the business entity tests have been abolished, effective from April 2015. HMRC will continue to honour its commitment not to investigate for three years contractors who had previously taken the tests and secured a low risk score.

Contractors seeking to determine their level of **IR35** risk, and the likelihood of an investigation turning into a full blown status enquiry, can take HMRC's online business entity test.

The new test, being used from May 2012 and which will be trialled for 12 months, is based on 12 online questions **limited company contractors** can answer about their contracting businesses. Each question attracts a given weighting and, depending on their answers and resulting score, contractors will find themselves assigned a risk category: high, medium or low.

HMRC's intention is to use the business entity test to screen limited company contractors into these risk bands and focus its compliance activities on those contractors most likely to be inside IR35. Contractors falling into the low risk category, and who are able to back up their answers with solid evidence, are less likely to have to undergo an HMRC status enquiry and may not come into HMRC's focus for a further three years.

But contractors falling into the medium and high risk bands may find themselves subjected to full-blown IR35 status enquiries. This could result in a status inspector concluding that they are operating inside of IR35, and as a result they may be required to pay back taxes, penalties and interest.

IR35 business entity tests – the process

The new process, which is designed to streamline IR35's administration by HMRC, will start by HMRC asking each contractor at the outset of any status enquiry the question:

"Have you considered IR35? If so why do you consider yourself to be outside of IR35? Please provide evidence to support this answer."

Contractors who can provide satisfactory evidence that they are not in **disguised employment**, and are a genuine business undertaking, will have the status enquiry halted and won't be required to undergo another status enquiry for three years.

The business entity test score will be considered as part of the evidence a contractor can use to demonstrate that they are 'in business'. HMRC has also created six IR35 scenarios providing examples of where, in its opinion, IR35 would apply and where it would not.

However, it is important to note that, because the underlying IR35 legislation has not changed, contractors should also use IR35 best practice, such as securing a **confirmation of arrangements** and obtaining **contract reviews**, to make their 'in-business' case.

To speed up status enquiries, HMRC has committed to create new teams with IR35 specialists who can quickly assess a contractor's IR35 status and shut down an enquiry if a contractor is clearly operating outside of the legislation.

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IR35 business entity tests – the questions

The 12 online questions and scores that make up HMRC's business entity tests are as follows:

Test #	Area	Question	Score
1	Business Premises test	Does your business own/rent separate business premises which are separate from your home and client's premises?	Yes = 10
2	P11 test	Do you need professional indemnity insurance?	Yes = 2
3	Efficiency test	Has your business had the opportunity in the last 24 months to increase your business income by working more efficiently e.g. by finishing the work/project earlier than projected but still receiving the full agreed payment? For example you originally agreed with the client/engager that the work would take 3 months and cost 10,000 but you finished in 2 months and still received the full 10,000 at the end of the 2 month period.	Yes = 10
4	Assistance test	Does your business engage one or more workers who generate at least 25% of your business turnover annually?	Yes = 35
5	Previous	Have you been engaged on PAYE employment terms by your current client/end user within the last financial year with no significant changes to	Yes =

	PAYE test	your working arrangements? If you are doing the same work you should answer yes to this question. Current engager also includes working at a different location owned by your engager or working at a different company but which is connected e.g. part of the same group.	(minus) -15
6	Advertising test	Has your business invested over £1,200 on advertising, excluding entertainment in the last 12 months?	Yes = 2
7	Business Plan test	Does your business have a business plan with cash flow forecast, that is regularly updated, and a business bank account which is separate from your personal account and identified as a business bank account by the bank?	Yes = 1
8	Repair At Own Expense test	Would your business have to bear the cost of having to rectify any mistakes?	Yes = 4
9	Client Risk test	Has your business been unable to recover payment for work done during the last 24 months in excess of 10% of annual turnover?	Yes = 10
10	Billing test	Do you invoice for work carried out prior to being paid and negotiate payment terms?	Yes = 2
11	Personal Service test	Does your business have the right to send a substitute?	Yes = 2
12	Substitution test	Has your business hired anyone in the last 24 months to do the contracted work you have taken on? This could be demonstrated by sending a substitute in your place or by sub-contracting, but in both cases your business remains responsible for the work and for paying the substitute or sub-contractor. You can still pass this test if you had to notify the end client of the name of the individual you sent as a substitute.	Yes = 20

High Risk = 0 – 10 points

Medium Risk = 11 – 20 points

Low Risk = 21 points and above.

Based on the current scoring/weighting structure imposed by HMRC, a great many genuine contractors will find themselves in the medium and high risk categories.

The business entity test has not replaced IR35

But contractors should bear in mind that the business entity tests are purely a screening process intended to help HMRC better target its compliance activity. The underlying legislation has not changed, so should a contractor find themselves in front of a tribunal judge, it will be the IR35 legislation and [case law](#) that will matter, not the results of a business entity test or how a contractor fits into HMRC's six IR35 risk scenarios.

The work of the [IR35 Forum](#) was supposed to result in 'better administration' of IR35. In practice, HMRC's business entity test and IR35 risk scenarios simply add an additional layer of complexity. This is likely to result in many more innocent contractors being forced to undergo lengthy, stressful, expensive and unnecessary IR35 investigations.

Contractors are well advised to continue to invest in [investigation insurance](#), contract reviews and IR35 best practice, particularly if they score badly in HMRC's business entity tests and would be the likely target of a status enquiry. In addition our free [online IR35 status test](#) can help contractors understand their current exposure to IR35.

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