

IR35 compliance letters – contractor guidance on how to respond

Contractors receiving a new-style **IR35** compliance letter from HMRC should seek professional assistance and respond promptly. The revised IR35 processes introduced by HMRC in May 2012 means going it alone is a high-risk strategy, and could result in a simple status enquiry escalating into a full blown **HMRC IR35 review**.

"Following the **launch** of its new risk-based approach to administering IR35, HMRC no longer disguises IR35 reviews as regular company compliance investigations," explains **Andy Vessey** of IR35 specialist **Qdos Consulting**.

"IR35 reviews are now directed and guided by experts from one of HMRC's four dedicated, specialist IR35 compliance teams. These factors make it even more important that contractors don't try to deal with their compliance letters alone," suggests Vessey.

New-style IR35 compliance letter format

According to Vessey, letters from HMRC initiating IR35 reviews of one person **limited companies** used to be thinly disguised, by stating the primary purpose was an employer's Pay As You Earn (PAYE) compliance review or, on rare occasions, a corporation tax investigation.

But that's no longer the case, and Vessey has seen numerous versions of the new-style letter sent to clients he represents. They all follow a common theme: "It is even more obvious now what HMRC is looking for. HMRC will confirm that its interest is not in corporation tax or PAYE and will typically ask for three items." These are:

Documents and spreadsheets that provide a breakdown of the gross income for a specific accounting period. Vessey says that HMRC usually focuses on a particular financial year, which it requires to be supplied within 30 days

Copies of contracts that give rise to the income breakdowns requested in item 1. This means HMRC want to see all of the contractor's contracts for the financial year under review, also to be supplied within 30 days

Finally, HMRC will ask an IR35-specific question, which will be a variation on: "Please can you tell us whether you have considered the possibility of your contracts being subject to IR35? If you believe that IR35 has not applied in the year in question, please explain the basis of how you arrived at these conclusions."

Vessey notes: "Clearly it is the final question that is key, but it does potentially allow a contractor to close down an investigation before it gains momentum, if an expertly prepared dossier is promptly despatched in response."

How not to respond to HMRC enquiries

Having dealt with hundreds of 'old-style' IR35 investigations, and numerous 'new-style' reviews, Vessey has seen many examples of how contractors who tried to go it alone managed to dig themselves into a costly IR35 hole. Here are some examples of contractor 'bloopers' and important 'don'ts' that he has shared with ContractorCalculator:

Supplying too much information: where contractors have chosen to 'carpet bomb' HMRC with documents, which have included organisation charts and internal telephone directories not identifying the individual as a contractor, and generic internal rules and regulations which did not apply to contractors, but were not explained properly, and therefore led HMRC to conclude that they do apply to the contractor

"I'm doing pretty much the same job now as I was when I was previously employed by my client": Yes, a contractor really said this to an HMRC inspector, suggesting that the contractor did not actually leave their job but incorporated for tax avoidance purposes

"Before I got the job, I had to submit my CV and attend a job interview": HMRC will seize on employment-like terminology, which should be avoided

"My contractors are just bums on seats": In one of Vessey's cases, the inspector was told by the contractor's project manager that the contractors were no different from employees. Vessey intervened and the client retracted the statement. Get the client onside and on message from the outset is the lesson from this example

"I'm so expert it's unlikely that the client could replace me": A contractor proudly told HMRC that he was irreplaceable, as no one else had his level of expertise, so substitution was impossible. The case hinged on **personal service** so Vessey's response was to track down the 25 contractors in the UK similarly qualified and so prove that, in principle, a **right of substitution** was possible

"If I complete the project ahead of schedule, my client finds me something to do until the contract period is over": This statement implies there is a **mutuality of Obligation** (MOO) between the contractor and the client, which is a strong indicator of employment and IR35

"I guess my line manager tells me what to do during office hours of 9-5, Monday to Friday": Vessey ensured that HMRC recorded that the contractor's work was overseen by a project manager and that the contractor had flexibility over when the work could be completed, not that the contractor was controlled by a manager during office hours, as the recorded statement implied

Agreeing to a meeting: HMRC likes meetings because it is easier to catch out contractors. They typically record contractors using employment terminology and revealing more information than is legally required. Taxpayers are not obliged to attend meetings and can conduct an entire investigation via correspondence, and preferably via their professional adviser

Taking calls: Experienced HMRC inspectors are effective at coaxing contractors to describe their situation, such as working arrangements, in employment terms. Contractors do not have to deal direct with HMRC over the telephone; they can conduct their case via correspondence or their professional adviser

Signing meeting notes: On rare occasions, with a confident and savvy contractor has a strong case, Vessey does agree to meeting because there is the potential to close down an investigation quickly. But he advises contractors against signing the notes about the meeting which HMRC will prepare, because this may prejudice a future defence if the investigation escalates.

Vessey reinforces the message that contractors should not try and respond directly to HMRC: "Despite the new processes, HMRC still uses the same tactics designed to ensnare contractors. A professional adviser not only ensures that the correct, non-employment, terminology is used, but also protects a contractor's rights as a taxpayer."

Why a prompt response is required

Another feature of the new compliance regime is the speed at which HMRC drives the process. Vessey explains: "A contractor client received a compliance letter requesting a significant amount of documentary evidence to be supplied within 30 days when the contractor was right in the middle of preparing a complex public sector tender.

"In the past, HMRC inspectors would normally allow an extension of the deadline to supply documents on an informal basis. I spoke to the inspector who had issued this letter and whilst he was happy to provide extra time, he said that it would have to be on a formal basis and he would issue an 'Information Notice' to that effect."

Vessey believes that there are two implications of this change in behaviour: "If contractors fail to comply with a formal Information Notice, they can be fined an initial £300 and £60 per day thereafter. Prior to the new administration processes, it might take many months for HMRC to get to the stage of issuing formal notices.

"It is my understanding from new cases that the urgency is as a direct result of the [IR35 Forum's](#) work on highlighting how long IR35 cases have historically taken to run their course. By issuing formal notices, HMRC can take control of the schedule. However, the flipside, and potential benefit to contractors, is that IR35 reviews can be resolved much more quickly."

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Andy Vessey, Qdos Consulting

Preparing a formal response to an IR35 compliance letter

Having been contacted by a contractor in receipt of a new-style IR35 compliance letter, Vessey implements the following steps:

Assembles and reviews the contracts under investigation by HMRC

Extracts the information about actual working practices from the contractor, and possibly their client

Creates a dossier providing evidence that the contractor is outside IR35.

"The dossier we assemble to send to HMRC for contractors will include the documentary evidence that focuses on the requirements of the IR35 legislation," explains Vessey. "It will detail all of the positive pointers, which is why it is so important for contractors to adopt IR35 best practice at all times, and at every stage of each contract."

HMRC's next steps after receiving an 'at risk' contractor's response

Vessey says that HMRC's next steps will very much depend on the strength of the evidence supplied by the contractors: "If the contractor has strong evidence that other employment status factors put them outside IR35, then HMRC will accept the evidence and halt the review.

"However, contractors unable to provide convincing evidence are likely to be subject to a full-blown IR35 review. HMRC's next step in this scenario is to contact the client, and to request a client's contact name and address from the contractor."

HMRC will assemble a list of questions for the client, which they may share with the contractor if they or their IR35 adviser requests it.

Get the client onside at an early stage

Ideally, the contractor will have got their client onside from the moment they first received the new-style compliance letter, explaining that they are under investigation and asking if the client would allow the contractor's IR35 adviser to make contact.

"Clients are not obliged to attend a meeting with HMRC, although communications from HMRC neglect to mention this fact when requesting one," says Vessey. "If the client confirms the evidence that the contractor is outside IR35, then HMRC will halt the investigation."

But Vessey warns that clients can also be the cause of the initial investigation escalating into a full blown IR35 review.



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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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"The key to contractors succeeding in this new regime is to respond promptly and with professional assistance," concludes Vessey. "The vast majority of genuine contractors will then find that their professional adviser will close down the review before it gets off the ground."

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