

IR35 reviews by HMRC: how they work

An **IR35** review by HMRC can take up a **limited company** contractor's time and energy over months or even years. But how do they actually work, and can they be avoided?

Andy Vessey of IR35 specialist **Qdos Consulting** is reassuring: "Genuine contractors who seek expert advice as soon as HMRC makes it move can stop an investigation in its tracks. If they've adopted **IR35 best practice**, they should have all the evidence they need to quickly satisfy an HMRC inspector."

"However," Vessey warns, "contractors unable to provide satisfactory evidence, or whose client won't play ball, could be in for the long haul as HMRC implements its full IR35 review process. This could ultimately lead a contractor into the **Tax Tribunals** and beyond."

How an IR35 review begins - "the letter"

A comprehensive **summary of IR35 guidance** from HMRC published in June 2014 highlights that the taxman will assess contractors as low risk, medium risk and high risk. According to HMRC, those contractors falling into the medium and high risk bands are likely to be investigated.

According to Vessey, from a contractor's viewpoint all IR35 reviews start with a letter from HMRC: "An IR35 status inquiry can be dressed up as an employer compliance review about payroll, or perhaps as a request to confirm or clarify a fact on a contractor's tax paperwork."

"HMRC has multiple sources of information and teams dedicated to researching and risk assessing contractors for **IR35**, so they have no shortage of potential things to get in touch about. But since HMRC's guidance was introduced in May 2012, the first letter is often more direct." Vessey offers the following as a typical first letter to a contractor:

"Will you please tell me whether you have considered the possibility of the company being subject to what is commonly referred to as the IR35 legislation? If you have, and have concluded that the company is not subject to that legislation then please explain to me the basis upon which you arrived at that conclusion. I am asking this to help me be fully aware of and understand any view you may hold on the application of the IR35 legislation."

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Since 2009, HMRC has wide-ranging powers to request evidence using '**Schedule 36 powers**'. Vessey says these give the taxman the right to request "information relating to the affairs of a taxpayer past, present and future". So it is possible that the letter about IR35 could also include a request for documentary evidence according to Schedule 36, allowing HMRC to issue notices based on the suspicions of an officer.

What to do when the letter arrives from HMRC

"Contractors receiving a letter with the IR35 question or something similar, and/or a Schedule 36 request, should immediately assume that they are in the early stages of an IR35 review," states Vessey. "They should not respond immediately, but instead seek expert IR35 assistance – immediately."

Vessey advises contractors with **tax investigation insurance** to contact their insurer before taking any other action. This is normally a condition of such policies, and failure to do so could invalidate the policy: "The insurer will have its own roster of IR35 consultants who will represent the contractor, and it is vital that contractors cooperate fully."

He also warns contractors against going it alone: "Some experienced contractors are highly IR35-savvy. But this does not equip them with the tactics to handle correspondence, a meeting with an inspector, or to provide them with a full understanding of HMRC's powers and tactics."

"In every case I've seen when a contractor has tried to manage the IR35 review without professional help, the HMRC team has outwitted them; the process has become either unnecessarily extended or, in many cases, the contractor has ended up with a hefty additional tax and National Insurance Contributions (NICs) bill."

HMRC may suggest a face-to-face meeting, although it is often coached in such terms that it appears to be a demand that contractors cannot refuse. However, contractors do not have to deal with HMRC face-to-face. HMRC's own IR35 guidance from June 2014 confirms that they can handle the entire case by correspondence.

IR35 specialists like Qdos Consulting will usually try to halt an IR35 review right at the outset. This is typically done by providing a dossier of key written evidence, such as a **confirmation of arrangements** and evidence of being '**in-business**', which clearly establishes the contractor's contracts as being outside IR35.

Get the client on side

After securing expert help or activating tax investigation insurance, a contractor's next task is to get the end client(s) onside. Vessey emphasises that this is vital, as a contractor's defence may stand or fall based on the client's evidence.

"If the contractor is unable to satisfy the inspector with written evidence, or if little exists, HMRC will want to talk to the end client. This usually takes the form of a long questionnaire sent to the contractor's end client. Unfortunately, in practice it is often the human resources, legal or procurement departments who complete such questionnaires, and they have little idea of the nature of the contractor's relationship with their project manager."

HMRC's Schedule 36 powers mean that it can compel the client to cooperate but does not have the right to demand a meeting, so HMRC's contact can be confined to correspondence. Many end clients are not aware that they cannot be compelled to meet, so their typical reaction is to agree to HMRC's meeting request.

Ideally, the contractor should introduce their IR35 advisor to the client. This is not to tamper with the evidence in any way, stresses Vessey, but purely to ensure that the client uses the correct terminology when describing their relationship with the contractor to HMRC.

Regulation 80 and section 8 income tax and NIC assessment

"There may come a stage when the contractor's options have been exhausted and HMRC remains convinced that the contracts under scrutiny are indeed inside IR35," says Vessey. "At this point, the investigating inspector will raise an assessment for the tax and NICs HMRC believes are owed by the contractor's limited company under IR35."

HMRC will issue two assessments for all the years concerned:

Unpaid Pay As You Earn (PAYE) income tax determined under [regulation 80](#)

Unpaid NICs determined under [section 8](#).

According to Vessey, this is also the stage at which a contractor's professional advisors can try to do a deal and negotiate down the assessment: "If one of the contracts under assessment was borderline, an HMRC inspector might consider doing a deal if the contractor pays the tax and NICs outstanding on the other assessments without appeal."

Appeals and dispute resolution

Following the assessment, the contractor has 30 days to appeal and request that the case be heard before the first tier tax tribunal. But the IR35 review is not on hold during this period or whilst waiting for the tribunal, which can be many months in the future.

Vessey has seen frequent examples of last-minute evidence, perhaps from a client who was overseas during HMRC's information-gathering stage, which has swung the case in the contractor's favour.

There is also the option of HMRC's [alternative dispute resolution \(ADR\) process](#) for small businesses, which Vessey says can be very effective: "HMRC's ADR process involves having the case reviewed by another experienced HMRC investigator, called a facilitator, who has previously had no dealings with the case and whose role is to objectively assist."

"Yes, it is another HMRC inspector, but the ADR process can highlight cases brought by 'awkward' inspectors and my experience of them has been positive. ADR is often worth trying, because there is no negative impact on a case but it could find in favour of the contractor."

The added advantage of ADR is that it can provide a fast result, with average turnarounds of 45 days, and even complex cases not taking more than 90 days. So ADR could settle an IR35 case without the need to go to a future tribunal that has already been scheduled.

Tax tribunals and higher courts

If no further evidence is forthcoming and ADR proves to be unsuccessful, the day may eventually come when the contractor's case is heard before the first tier tax tribunal. Vessey, who routinely represents clients in tax tribunals, says the process at this stage is quite straightforward.

"HMRC and a contractor's advisors each prepare a 'bundle' of evidence for the tribunal judge," he says. "Then HMRC's representative – typically an inspector specialising in appeals hearing work – and the contractor's advisor make their arguments and summations to the judge."

"Either party can introduce witnesses, such as client representatives who may be a witness for the contractor or for HMRC. The contractor typically gives evidence as well, and all witnesses can be cross-examined."

The judge will issue a ruling some months later, based on the evidence submitted at the tribunal. If either side chooses to appeal, the appeal is heard in the upper tax tribunal and the hearing process is repeated, sometimes with additional evidence and witnesses.

In extreme cases, usually when there is a point of law at stake and the contractor is backed by PCG, the case may proceed to a higher court.

What happens if the contractor loses

"If the contractor wins at any stage and HMRC chooses not to appeal, they walk away with the regulation 80 and section 8 assessments reduced to zero and, very rarely, costs may be awarded," continues Vessey. "But if the contractor loses, their limited company becomes liable for unpaid income tax, NICs, interest and possibly penalties. And at this stage it is far too late to try and cut a deal with HMRC."

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The final assessment is calculated by HMRC based on the deemed payment the contractor would have made during the contracts found to be inside of IR35, less a corporation tax deduction for the years in question. HMRC also has the power to impose a penalty. However, if there was no fraudulent intent on the part of the contractor then HMRC rarely imposes a penalty.



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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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"Fortunately the number of IR35 cases that work through the entire process are few," notes Vessey. "And contractors can do a lot themselves to prevent an investigation ever taking off by always adopting IR35 best practice for all of their contracts."

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