

IR35 taxes uncollectable if contractors' company has no money

Contractors who have been found to be inside [IR35](#) but whose company has no cash and cannot pay the resulting tax, interest and penalties are safe from HMRC transferring the liability to them personally.

"There is legislation known as '[Regulation 72](#)' that makes provision for transferring unpaid tax debts to an employee," explains [Andy Vessey, Qdos Consulting](#)'s IR35 expert. "However, it is incredibly unlikely that HMRC could make these rules stick in the case of a contractor's limited company being unable to pay IR35 debts."

As long as a contractor can demonstrate that they have applied the necessary due diligence when [determining their IR35 status](#), Vessey believes that HMRC would not be able to transfer the debt to the contractor personally.

However, the lack of personal liability does not negate the fact that an IR35 review is a costly, time consuming and stressful experience for contractors. Contractors should always take out [tax investigation insurance](#) to meet these costs, which can run unto many thousands for just a basic inquiry.

Regulation 72, and when it applies

The tax legislation that enables HMRC to transfer tax debt to an individual employee is Regulation 72 of the [Income Tax \(Pay As You Earn\) Regulations 2003](#), usually known by tax experts simply as 'Regulation 72'.

"Regulation 72 can only be applied under two circumstances," continues Vessey. "Firstly, debt can be transferred when an employer has taken [reasonable care](#) to comply with the legislation but failed to deduct tax from an employee's salary 'due to an error made in good faith'.

"The rules can also apply if the employee knows that their employer 'wilfully failed to deduct the amount of tax which should have been deducted from those payments', which means the employee colluded with their employer who deliberately did not pay the employee's income tax."

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Andy Vessey, Qdos Consulting

Exercising IR35 due diligence

Vessey continues: "If you take the first circumstance, most contractors will exercise reasonable due diligence with their contracts and take professional advice about whether IR35 applies.

"So, when you have the situation that a contractor genuinely believes in good faith that IR35 does not apply, then they will not go through the process of calculating the deemed payment or make any tax deductions.

"HMRC may then come along and say 'we disagree and believe that IR35 does apply so you need to pay the income tax'. If the contractor had made the decision not to pay tax in good faith based on their IR35 due diligence, and the company can't pay the ensuing tax bill, then HMRC can't apply Regulation 72 because there was no error in the first place."

'Wilfully' failing to deduct tax

Vessey notes that the second circumstance will also not apply in an IR35 case: "In a contractor limited company, the employer and the employee are the same – the contractor. Let's say the contractor has done their IR35 due diligence and concluded that no tax should be paid.

"That means that the employer – the contractor – and the employee – also the contractor, have taken advice and believe that they are outside IR35. So, if it is an error then it was made in good faith.

"And the employer – that's the contractor's limited company on instruction by the director, also the contractor – could not have 'wilfully failed to deduct' the tax because the employer believed that no tax was due."

When Regulation 72 does apply

However, Vessey warns that the converse is true: "Let's imagine that the contractor sought professional advice about their IR35 status and the outcome was that they were well and truly caught by IR35.

"If the contractor totally ignored the findings of their review, and failed to make a deemed payment or pay themselves a salary, then Regulation 72 could well apply if an HMRC enquiry subsequently found that IR35 also applied."

Vessey believes that under these circumstances, HMRC could in theory have a strong case to apply Regulation 72. The taxman could then go after the

contractor for the unpaid income tax, interest and penalties.

"However, I've never known HMRC to apply Regulation 72 in an IR35 case," adds Vessey. "The closest I have seen is in the [Larkstar Data IR35 case](#), when the contractor Alan Brill gave up the fight because he retired. HMRC went to the then Special Commissioners for a ruling in principle, even though the taxman knew there was no money left in the company to pay any tax settlement awarded by the tribunal."

Contractors closing their companies beware

As Vessey explains, there is one other scenario when contractors may be worried about Regulation 72, and that's when they are closing down their contractor limited company: "If a contractor has ceased trading and have no further use for their company, they would normally ask Companies House to strike-off the company.

"As part of its routine risk profiling, HMRC actively monitors the striking-off list of companies, and may challenge the striking-off order for a contractor limited company and raise an IR35 enquiry, even though there is nothing left in the company. Contractors in this situation may be concerned that HMRC could apply Regulation 72 and go after them personally for unpaid tax.

"Assuming they are confident that they can evidence that IR35 due diligence was completed for each past contract, then contractors in this situation should not be intimidated by HMRC, as Regulation 72 will not apply."

Vessey highlights that when HMRC take this course of action, it is a complete waste of the contractor's and taxpayers' time and money, because there will be no money to pay any IR35 tax bill and no prospect of recovering it.

Making provision for costly IR35 investigations

Even though a contractor may not be personally liable for any tax, NICs, penalties and interest due as a result of being found inside IR35, they may still be financially crippled by the fees required to fund an IR35 defence.

Similarly, if their IR35 due diligence can readily prove that HMRC has got it wrong and they are not caught by the legislation, the process of a professional defence can cost thousands of pounds in professional fees. Even if HMRC have virtually zero chance of making the case stick, they can still drag out the case over months and years.



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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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As a result, in addition to maintaining their IR35 best practice, contractors should consider tax investigation insurance that will cover the cost of a professional to manage an inquiry. A comprehensive policy can cost per month the equivalent of a round of drinks.

Vessey concludes: "Because IR35 is such a grey area, HMRC will experience a great deal of difficulty in proving that Regulation 72 applies, which is probably why we have never seen it applied in an IR35 case."

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