

advice and therefore needs to have that advice documented.

Paperwork

Is the client always late? Is his paperwork in a poor state? Quite often, these are the clients that give rise to claims. The adviser will bend over backwards to help the client but the assistance given by the adviser is not always documented. It is helpful to identify and document any problems. It can be done in quite a tactful way. For example, if a client is always late with his paperwork, the adviser could

write saying that he has traditionally been late with his paperwork and that gives rise to particular risks and that, if he wants to, the professional could help by doing XYZ for an additional fee. Even if the client does not take up the offer, there is documentary evidence on the file that the problems are caused by the client and that the client is aware of them.

Writing such a letter assists in passing the risk from adviser to the client, it might help the client realise he needs help. It might lead to an additional fee for your firm.

Spending a little time now considering your firm's processes and procedures can be beneficial in minimising the risk of claims against your firm and the adverse consequences thereof.

TPT

Karen Eckstein

*Karen Eckstein, Lake Legal LLP
karen.eckstein@lakelegal.co.uk
DDI: 0845 190 0004. Fountain House, 4 South Parade, Leeds, LS1 5QX, www.lakelegal.co.uk*

The IR35 Business Entity Tests

David Kirk explains these new tests for IR35.

How we got here

The saga of IR35 goes on and on. Mired in controversy from the start; changed from the initial proposals so that big companies did not have to put themselves at risk of making the wrong employment status decision, and then subjected to judicial review.

The failure of IR35 to work effectively brought us the managed service company legislation seven years later, with personal liability for PAYE.

According to a recent Freedom of Information request, yield from IR35 investigations has risen fivefold from £219,000 in 2010/11 to £1.25 million in 2011/12. HMRC have also set up three specialist units to do IR35 'employer compliance checks' (as this kind of enquiry is now known) and almost all IR35 based enquiries should now come from one of these units. The level of activity on IR35 enquiries has already risen from 23 to 59 cases

in the last year, and I expect it to rise further.

Prompted by the Office of Tax Simplification's review of the subject, HMRC have also published a set of 'business entity tests', with a view to making it easier for people to decide whether they are

at risk of an IR35 enquiry. It should be stressed that there is no new law here: these tests are a tool for HMRC to decide whether to *examine* a company for IR35 compliance, not to decide whether IR35 ought to be operated.

Taxpayer participation

The taxpayer can participate too. Using a points system, the tests allow the contractor, and HMRC, to grade the company as low risk, medium risk, or high risk. Score more than 20 points and you are 'low risk', and HMRC then promises that:

'If your evidence proves to our satisfaction that IR35 does not apply to you or that you are in the "low risk" band, we will close our IR35 review. And we will undertake not to check again whether IR35 applies to you for the next three years, provided that:

- *the information you have given us is accurate;*
- *your circumstances – and, in particular, your working arrangements – do not change in that time.'*

Wow! This looks too good to be true, does it not? More on this later. In the meantime you may have noticed a chicken-and-egg problem here: how can HMRC classify the risk without first going quite a long way down an 'employer compliance review'?

Encouraging signs

The first signs of the operation of these tests are actually quite encouraging: HMRC appear to be a great deal more honest in saying in their letters that they are examining IR35 compliance, so the taxpayer can quickly address the issues that are actually at stake rather than engage in the kind of shadow-boxing that has so often featured in the past.

Most (but not all) of the tests are intelligently constructed, and have had the benefit of input from the private sector, through the IR35

It should be stressed that there is no new law here.

Forum. There is a strong hint of practicality about the tests: some of them look at the traditional employment status tests whilst others look at the sort of behaviour which, although not forming any of those tests, would tend to distinguish an independent contractor's company from someone within IR35. The more points you get, the lower the risk. Above 20 points is low risk, 10 to 20 medium, and below 10 high.

The tests

These are the business entity tests (points shown are for positive answers):

- 1 *Does your business own or rent business premises which are separate both from your home and form the end-client's premises?* (10 points)
 - 2 *Do you need professional indemnity insurance?* (2) Note 'do you need?', not 'do you have?'
 - 3 *Has your business had the opportunity in the last 24 months to increase your business income by working more efficiently?* (10) This is really aimed at fixed-price contracts.
 - 4 *Does your business engage any workers who bring in at least 25% of your yearly turnover?* (35 points) Quite right too – this would be pretty conclusive against IR35 applying.
 - 5 *Has your business spent over £1,200 on advertising in the last 12 months?* (2) It is hard to go along with this one when so many one-man bands get most or all of their business by word of mouth; the social media that are becoming more and more popular and costs nothing. Even those who do advertise are unlikely to spend £1,200 a year, so do not expect many to pass it.
 - 6 *Has the current end client engaged you:*
 - *on PAYE employment terms;*
 - *within the 12 months which ended on the last 31 March; and*
 - *with no major changes to your working arrangements?* (-15)
- So it's a game of snakes and ladders and here is the snake. We know that IR35 was originally set up because HMRC were suspicious of arrangements whereby people went from PAYE on Friday to limited company the following Monday, whilst doing exactly the same work. No surprises about this one then, and if it does apply it is going to be pretty difficult to be accepted as low risk.
- 7 *Does your business have:*
 - *a business plan with a cash flow forecast which you update regularly; and*
 - *a bank account, identified as such by the bank, which is separate from your personal account?* (1)
 - 8 *Would your business have to bear the cost of having to put right any mistakes?* (4) In theory this is quite a strong indicator, but a difficult one to establish in practice as for many contractors – notably in the IT world – the cost is the contractor's time, not any physical bill that he has to pay. HMRC's guidance does not make it clear whether this is included, and perhaps it should.
 - 9 *Has your business been unable to recover payment:*
 - *for work done in the last 24 months; and*
 - *more than 10% of yearly turnover?* (10)
- This test is ridiculous and proves nothing: many contractors get paid by other intermediaries such as employment agencies. They may well be inside IR35 and are just as likely to suffer a bad debt as anyone else. Indeed, in the context of IR35 a big bad debt would indicate over-reliance on one sort of income – a more likely problem for those inside it than those outside IR35. This also illustrates the arbitrary nature of some of these tests. Ten points is enough to get you out of the high risk category on its own, but what happens if your bad debt amounts to 9.8% of annual turnover – does this small difference mean that it is of no account? It would really be better if there were a sliding scale, say 1 point for each 1% of turnover.
- 10 *Do you invoice for work carried out before being paid and negotiate payment terms?* (2) This once again looks at business behaviour: as business status tests both of these would seem rather simplistic. For example, many contractors are required to operate 'self-billing', where the invoice is actually produced by the client – something that is unlikely to persuade a court that they are in business on their own account.
 - 11 *Does your business have the right to send a substitute?* (2) This is an old favourite, with the courts often ignoring substitution clauses that have no basis in reality. HMRC is quite justified in paying far more attention to test number 12.
 - 12 *Have you hired anyone in the last 24 months to do the work you have taken on?* (20) Superficially this looks good, but in practice it could be problematic. On the face of it, the test requires the contractor to provide a substitute for half a day every two years. If he can dredge up another point from somewhere else, he is automatically considered low risk. Bingo! – write to HMRC with the evidence and they will leave you alone for another three years.
- If this really is all it takes, it is hard to see this test lasting long. It would be much better to combine test 12 with test 4 and operate a sliding scale here as well – say 2 points for every 1% of turnover that is brought in by someone else.

*This looks too good
to be true,
does it not?*

Finance Bill 2013

Draft legislation for inclusion in Finance Bill 2013 will be published on 11 December 2012, together with responses to 35 separate policy consultations conducted since Budget 2012. The draft Finance Bill clauses will be open for consultation until 6 February 2013.

Action against tax avoidance

HM Treasury have announced the manpower and brief of two HMRC specialist units will be expanded as follows:

- The affluent unit will be expanded to deal with taxpayers with a net worth of £1 million instead of the current asset value of £2.5 million. This is expected to increase the number of taxpayers covered to 200,000, and an extra 100 tax inspectors will be moved into this unit to cope with the extra work.
- The team working on disclosures made under the Liechtenstein disclosure facility will be doubled in size.

In addition the Cabinet Office and HMRC have been tasked with working out how the procurement process for government contracts can be changed to deter companies who use aggressive tax avoidance schemes.

Direct sellers disclosure

HMRC launched a disclosure opportunity aimed at self-employed direct sellers on 26 September 2012, which will run to 28 February 2013. Direct sellers generally sell directly to the public, without the use of a shop

or other premises. Their sales are commonly initiated on the doorstep possible using a catalogue, in people's homes or at product parties. They may be referred to as representatives, distributors or consultants.

HMRC believe a large number of direct sellers should be registered as self-employed businesses, but do not understand their obligations under the tax system. The boundary between employed and self-employed can be blurred, particularly where the seller deals only with one company's products and is paid solely on commission. To help direct sellers understand their tax position HMRC has placed a short educational video on You Tube (www.lexisurl.com/dirseller).

IR35 yield rises

Through a freedom of information request submitted to HMRC, Bloomsbury Professional has discovered the tax yield from IR35 investigations has increased fivefold in the last year; from £219,000 in 2010/11 to £1.25 million in 2011/12. The number of IR35 investigations opened in 2011/12 has also more than doubled from 23 to 59. Martin Casimir, managing director of Bloomsbury Professional, commented: "It looks like HMRC has been playing catch-up on IR35 in the past year. They have gone from almost ignoring IR35 breaches to getting tough around the time that the public sector personal service company scandal began to break."

SDLT avoidance

HMRC has won a key tax avoidance case: *Vardy Properties* [2012] UKFTT

564 (TC). The taxpayer tried to avoid SDLT on the purchase of a property by relying on sub-sale relief. Ian Maston of Gabelle commented: "This is the latest of a number of recent tax avoidance cases that has been won by HMRC and practitioners should tread carefully when advising their clients about tax avoidance schemes because the tribunals and courts seems to be increasingly hostile to them."

New taskforce targets

HMRC has announced taskforce tax investigation teams to target trades and professions in the following areas:

- legal profession in London;
- grocery and retail in South and North Wales, North West and South West England;
- hair and beauty in the North East;
- restaurants in the South East and the Solent areas; and
- the motor-trade in Scotland.

31 October deadline

Paper self-assessment tax return forms for 2011/12 must be submitted to HMRC by 31 October 2012. If these tax returns are received on or after 1 November 2012 a £100 penalty will be issued, even if there is no tax to pay for the year. Taxpayers are encouraged to file their tax returns online.

The short version of the self-assessment tax return form cannot be submitted it online (see SA 210). Taxpayers who have been issued with the short return, and who need a further three months to complete the return must register to submit a full return online.

What is not asked

There are other cavils: for example, no attention is paid to how many clients a company has, which is not only one of the most important employment status tests but also one of the easiest to measure. However, this is to quibble: HMRC are expecting to review the tests after a year, and they represent a

good start to resolving an almost insoluble problem. HMRC are also likely to say that they will consider other evidence if someone considers himself to be low risk.

I wish both HMRC and the contracting fraternity luck with this.

TPT

David Kirk

*David Kirk MA FCA CTA is a specialist consultant in payroll taxes, and represents the ICAEW in the IR35 Forum (however the views expressed here are his own). He can be contacted at dk@david-kirk.info or on 07778 361552. His book *Employment Status – the Tax Rules* is published by Claritax Books.*