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IR35 - The Business Entity Tests

The new Business Entity Tests, being announced by HMRC this week, are the latest attempt to provide some certainty to contractors who return a low risk rating to the tests; but what about everyone else?

Background

Following the review of IR35 carried out by the Office of Tax Simplification it was recommended that the IR35 Legislation remains in place with no amendments, these recommendations were adopted by the Chancellor and announced in the Budget of 2011.

HMRC agreed during that review process that enforcement was cumbersome and taking excessive lengths of time; resulting in high levels of stress for anyone involved in an enquiry.

It was then agreed that a group would be setup to review how IR35 could be enforced more effectively within the unchanged legislative framework.

The result of this groups work is the Business Entity Test.

Changes to IR35 Legislation

Many contractors seem to be under the impression that these tests in some way change the IR35 legislation - They don't.

There have been no changes to the IR35 Legislation and therefore these tests had to be designed to fit around the current rules.

The Tests

These tests are going to be used for twelve months and then the effectiveness, appropriateness and outcomes will be reviewed to see if they have achieved their objectives..

The Business Entity Test consists of 12 questions with weighted scorings depending on your answer.

It is our understanding that prior to an enquiry being opened into IR35 a business will be given the opportunity to take The Business Entity Test.

This is likely to mean that, rather than the 23 enquiries opened last year, HMRC now have the means to target thousands of contractors putting IR35 firmly back on the risk radar.

Having reviewed the questions, and scoring, it is our belief that very few contractors will achieve a low risk rating.

This will mean that there is likely to be significantly more enquiries as highlighted earlier.

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If you receive a medium or high risk rating you will have the opportunity to provide details of any assignment reviews carried out in establishing your IR35 status as outside IR35.

It is possible that HMRC will review these checks and feel that they represent a detailed and accurate assessment of status and therefore not take the enquiry any further; on the other hand they could move you further up the risk scale if they, in HMRC's eye, fall short of expectations.

Contract Reviews

Contract reviews is a slightly misleading term and a more accurate way to describe the review would be an assignment review.

IR35 assessments are based on an analysis of the actual working relationship between a worker and the end client, ignoring any relationships in-between. Where this relationship is considered too similar to that of an employee / employer relationship IR35 comes in to play.

As there is very rarely any contract to define this, the majority of contracts are between the recruitment company and the worker, these have become known as the notional contract.

Accurately assessing these terms at outset is what provides the best defence against IR35.

There are many organisations that offer IR35 reviews; in our experience the quality of these varies considerably and the old

rule of you pay for what you get seems to hold true.

If a review focusses primarily on the contractual terms between you and the recruitment company, with little or no real effort made to establish the true nature of the relationship between you and the end client, then the conclusion is likely to be weak at best and potential wrong.

Some accountancy service providers offer free IR35 assessments as part of their service. In our experience the majority of these fall short. You would be well advised to make sure you obtain the full terms and conditions of the review. Often you will find the review described as guidance or an initial assessment and the small print contains the requirement for you to take the responsibility of assessing your status.

You should ensure that when you have a review you are able to provide a copy of the report to HMRC to shortcut their enquiry, some prevent this and will void any insurance if you provide a copy to HMRC. You should also enquire whether the provider will defend their assessment if HMRC challenged the status and what the costs of defence would be.

Remember it is you, the contractor, that is responsible for assessing your status and confirming this to your accountancy service provider; they will advise you accordingly and prepare your accounts based on this instruction.

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You are the one that will receive fines and penalties if HMRC find your status to be different at some point in the future.

Having your assignments professionally reviewed, by a specialist firm, at outset, and on each renewal/extension will provide you with the best defence against in the new process.

Professional Passport has for many years worked with Bauer and Cottrell and recognises them as the experts in this field.

We have an arrangement with Bauer and Cottrell that provides our members with discounted assignment reviews and you can find full details on this here:

www.professionalpassport.com/Contractors/Member-services/296

Remember HMRC can go back 6 years so you should consider whether to have previous assignments reviewed for your complete protection.

IR35 Insurance - Caveat Emptor - Buyer Beware

There are some companies on the market that provide an insurance against an IR35 enquiries. This insurance goes beyond the traditional policy provided by accountants to their clients, that policy only covers any additional professional fees resulting in an enquiry form HMRC, as it also offers cover against any fines or penalties resulting from the enquiry.

This form of insurance contains many caveats and disclaimers that allows the insurer to pull out unless all conditions have been met.

In some cases you may have had a review and it was concluded to be outside IR35 that allowed you to purchase the insurance then at the point of claim a crucial piece of evidence comes to light that changes everything and allows the insurer to withdraw.

If this new process generates significantly more enquiries targeting high risk businesses we would predict that many insurers will use these claims to revert the policies to cover professional fees only. Many contractors could find themselves facing bills that they thought were insured.

There is no substitute for a professional review at outset to provide certainty; even HMRC are beginning to recognise this in the new process.

Professional Passport only supplies insurance that covers the professional fees you would incur in the event of an enquiry as we believe that this is the only long term sustainable cover that will actually pay out.

You will provide details here:

www.professionalpassport.com/Contractors/Quote-generator/196

Penalties

HMRC has strengthened its armoury over the last few years and contractors must remember that where HMRC successfully challenge their IR35 status they could be facing significantly more than a bill for the outstanding tax.

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Professional Assignment Reviews Fixed Cost per Annum

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Reasonable Care

When an IR35 enquiry is opened you have a responsibility to demonstrate that you took reasonable care in assessing that assignment's IR35 status.

It is widely accepted that this needs to cover both the contractual terms and a full examination of the actual working relationship between you and the end client.

It should be demonstrated by a written report that highlights all the points that lead you to reach a conclusion of outside IR35.

Without this HMRC have the power to apply penalties of up to 100% of the tax assessed.

Interest

Where HMRC successfully challenge your status they can, and will, apply an interest charge to the taxes assessed.

Name and Shame

Where HMRC successfully challenge the status and are able to apply penalties they can now also insist that they review all your business dealings for the next 5 years. This is likely to include reviewing all your assignments and confirming what, in their opinion, your status is.

In extreme cases they can also publish your name and address as a deliberate tax avoider. This could make it difficult to obtain assignments if you operate in sensitive areas such as

Government and Financial Services.

HMRC Contract Review Service

As part of these changes HMRC will be promoting their assignment review service.

This is a free service and contractors can provide the information to HMRC for them to carry out a review and assess status.

HMRC will be reassuring contractors that this review service is confidential and in no way relates back to the team that select companies for an IR35 review or enquiry; based on our experience it will take more than this to provide the reassurances that contractors seek.

For this service to stand any chance HMRC must demonstrate that they are carrying out assessments in line with previous case rulings and judgements; something they have not always done in the past.

Summary

The IR35 rules have not changed

Where you have a professional assignment review carried out, and you are able to demonstrate it, then HMRC could close the enquiry quickly.

More contractors are likely to find themselves questioned/challenged by HMRC.