

## IR35 - If you think it's all over, think again!

We know what the Budget said and if we have correctly interpreted what Mark Prisk apparently said to the Daily Telegraph; the odds on IR35 being consigned to the legislative dustbin by 6 April 2011 must be fairly short. So, that's it then, is it?

Well, if 'review' ultimately means 'abolition', then every freelancer in the country might think to base their remuneration package for the current financial year on the low salary/high large dividends model to pay the absolute minimum in tax and hang the consequences! After all, once IR35 is gone, it's gone isn't it?

No, absolutely not! And here is why....

The purpose of this article is not to guess what may replace IR35 – let us assume that a better solution to the issue of status is in place on 6 April 2011 – but to make freelancers and contractors aware that it is extremely unlikely that the Government will allow what may be the final year of IR35 to become some form of tax 'free-for-all'.

We can be certain that the requirement to complete tax returns and P35s will remain, so there is every reason to believe that HMRC will continue to undertake Employer Compliance Reviews (PAYE Audits), VAT Reviews and select tax returns for Full or Aspect Enquiries.

Enquiry activity is not going to go away. HMRC did not increase the information required on the tax and P35 returns just to let it stay stored away in a database. All the tax returns that will be submitted by freelancers during the current tax year for the last accounting period are vulnerable to a challenge, as are the several hundred thousand P35s submitted this May.

Unless there has been some 'behind the scenes' edict, we must assume that HMRC will start new enquiries under IR35 between now and next 5 April 2011 - if anything investigations activity has increased in the last six months over that in the previous year and a half.

HMRC are also unlikely to rush to close a current IR35 case down by the end of the tax year if they believe that they are correct in their opinion that the freelancer is 'caught'. Ask our investigations consultants if Inspectors have become any less tenacious or intransigent since the election and you will hear a resounding "No!"

So if that deals with the past and the present; what about enquiry activity under a new regime which we assume will be in place on 6<sup>th</sup> April next year?

Well, let us assume that HMRC decide to undertake an Employer Compliance Visit in September of 2011. No doubt they will continue their policy of reviewing the PAYE records for the tax year in which the visit takes place (2011/12 in this example) and the previous tax year which would cover the period to 5 April 2011 and which, based on our assumption, would be the last where IR35 would apply.



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# IR35

If the inspection establishes that a freelancer has been working for the same End Client throughout the period selected for review and the engagement looks suspiciously like disguised employment, then HMRC won't – and indeed can't - simply ignore the fact, but their only way of tackling this non-compliance in the earlier year would be under IR35. Similarly, if HMRC decide to undertake an enquiry into dividend income received on an individual's tax return to 5 April 2011, the enquiry could start as late as January 2013 and might look at the engagements relating to that return and indeed earlier years. Again, IR35 would be the only way to challenge disguised employment prior to April 2011.

Finally, an enquiry into a Corporation Tax Return is also a possible avenue to investigate status and the current enquiry regime is such that at time of going to press, it is possible that year-ends from 2008 and already submitted to HMRC, as well as year-ends that include significant periods of the current tax year will realistically be available to HMRC to review as late as the end of 2013. And the only method of challenging what HMRC perceives as disguised employment for all those accounting periods will be IR35.

So in case you think that the battle is won, remember there could be repercussions for several years yet. We know that IR35 enquiry cases have not yielded the income the Treasury anticipated, but IR35 seems to have worked as a deterrent to stop the vast majority of freelancers from paying themselves a salary equivalent to the personal allowances and taking the rest as dividends. If you assume that most freelancers will have paid themselves some salary - let's say £15K – then HMRC will have received around £3,000 more PAYE & NIC from perhaps 500,000 contractors who elected to pay a salary above the personal allowances and by our calculations that amounts to £1.5billion for the Treasury coffers.

Indeed the figure could be a lot higher: HMRC will also need to be on guard against freelancers who are 'caught' by IR35, but believing that the compliance regime is over, pay themselves as if their engagements were 'outside' for the 2010/11 tax year (and continue to do so until any new regime is introduced).

We cannot believe that HMRC will let that amount of money slip through their fingers; so the need for due diligence remains: contractors must continue to demonstrate that they are genuinely in business on their own account; engagements will still need to be reviewed to determine their 'IR35' status and freelancers must ensure that their businesses are protected from Revenue enquiries.

At Abbey Tax, we recognise that representation against IR35 disputes must remain part of our Tax Investigations Insurance policies for some considerable time yet, until the threat of enquiry has finally receded. We are committed to maintaining the existing comprehensive level of cover and to providing protection against enquiries under any new regime in the future.

HMRC won't allow a return to the 1999 position and as taxpayers, we shouldn't want them to let it happen – several billion lost through the taxman's complacency would only result in higher taxation elsewhere. We believe that HMRC aren't going to turn a blind eye and despite the positive news that suggests a better regime is on its way (we hope), it would be a mistake for the contractor community to become complacent.

You may think it's all over, but it will be a few years before we can honestly say ... "It is now!"

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