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IR35 Ignore, Review or Insure?

Following the recent introduction of the Business Entity Tests there has been an almost exclusive focus on the questions and scoring within the tests. This single minded focus could result in the real potential benefits of the changes being missed.

You will still see, and hear, from some calling for the abolition of IR35; the opportunity to abolish IR35 came during The Office of Tax Simplification IR35 Review instigated by the Government after the last general election. The outcome of this is well documented with no changes being made to the IR35 Legislation.

One of the other outcomes of this review was to set up a working group to see how HMRC could enforce IR35 more effectively.

What contractors have always wanted is a degree of certainty on their IR35 status rather than the lottery enforcement policy that has operated until now so are we now any closer to that certainty?

The first point to make, as we have stated previously, is that

the IR35 Legislation has not changed; the Business Entity Tests are no more than a way for HMRC to assess the IR35 risk profile of any business. This is designed to assist them in carrying out a more effective enforcement strategy. It is this last point that is the key.

In the last 3 years there have only been a total of 60 IR35 enquiries opened, an average of 20 per annum. This new strategy potentially allows hundreds, if not thousands, of enquiries to be opened.

We tend to agree with many of the comments suggesting that the tests, questions and scoring still needs more work to become meaningful although refining this could result in a greater degree of complexity and uncertainty so care needs to be taken. HMRC have committed to review the process throughout the 12 month trial and we are confident that this will happen.

Accepting that there are some issues with the tests does not remove the fact that a greater degree of certainty can now be achieved if a contractor so wishes. Firstly it is probably fair to say that the majority of contractors will return a 'high risk' result to the tests; so there is now certainty that, if HMRC start enforcing the policy as they suggest, there is a good chance you will be investigated.

That being the case it would be unwise to ignore IR35, so the key question is how to assess your IR35 status effectively and/or manage your risk.

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A significant potential benefit of the new tests for contractors is that the initial part of the process is to ask businesses whether they have considered IR35.

This simple, and on the face of it insignificant, part could hold the greatest clue for contractors on how to protect themselves and manage their risks down to acceptable levels, regardless of the Business Entity Test Results. We will explore and expand on this later in the article.

The decision on managing risks to acceptable levels seems to be boiling down to two key decisions:-

- **Take out insurance**
- **Have an assignment review**

We will now explore each of these options in detail.

Insurance

There are many types of insurance available on the market, the two most common for the contracting sector are:

- Covering the cost of additional fees as a result of an enquiry into your tax affairs.

This type of policy does not include any cover for additional tax liabilities or penalties.

- Covering the cost of additional fees as a result of an enquiry into your tax affairs; including specific cover to meet any additional tax liabilities assessed

as a result of the enquiry.

These policies usually cover both the additional tax as well as any penalties applied.

It is the second of these policies that we will look at specifically here as this is the one that many contractors tell us they are considering.

Before we look at the detail of the policies it is worth making a few key points:

- Insurance Companies are companies that are set up to make profits on their policies
- Underwriters look for areas where there is a high perceived risk with a low actual risk
- Policies are annually renewable

These points will help to keep some perspective on the subject as we explore further.

If we look at the number of IR35 enquiries opened by HMRC since April 2006 the figures are:

- 322 cases yielding £5.4 million

If we then compare this with the number of posts and articles written on contractor sites expressing fears over IR35 it is clear that the insurance underwriters dream of high perceived risk versus low actual risk **was** present in the area of IR35.

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The new strategy being adopted by HMRC, The Business Entity Tests, could significantly change the balance of this. If the pendulum swings too far the other way it is our belief that many of the current insurers will either withdraw from the market or significantly amend their terms.

These amendments could include the requirement to have a full assignment review before the insurance can be confirmed.

Some of the insurers on the market today already have these types of conditions within the policy terms which could result in many contractors finding themselves uninsured at the point of a claim.

Where this happens the contractor will not only have to pay the additional tax but they are also likely to face increased penalties as they will be unable to demonstrate reasonable care in assessing their status; also not forgetting that they will lose the insurance premiums they have already paid.

Where an insurer withdraws from the market the contractor will be left uninsured and totally exposed as the policies are designed to only pay out when an active policy is in place at the commencement of the investigation.

We believe that, in the long term, the only way insurers will be able to operate in the market, assuming HMRC apply this higher enforcement strategy, will be to insist on a full assignment review prior to accepting the policy application.

We would also expect to see an increase in the premiums for

these policies as the new enforcement strategy takes hold.

The question is now whether you need insurance if you have had a full assignment review? Why pay for both?

The other style of policy mentioned earlier, the one that covers the professional fees only, is likely to continue as it is not contractor specific and therefore any impact of enforcement strategy changes are aggregated across the whole market. This approach to risk assessment is unlikely to change the overall costings of the product.

Assignment Reviews

The second of the decisions faced by contractors in managing their risks is whether to pay for a professional assignment review and what protection that will provide to them in the new enforcement regime.

The first point worth clarifying is that there are a wide range of IR35 reviews available on the market and contractors must ensure they are buying the right review for their purposes.

These reviews whilst having a wide range of names generally fall in to two categories:-

- Basic Status Check or Contract Review

This service tends to be the cheapest offering and only reviews your contract; you will not be asked any details around your actual working relationship with the end client.

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The service simply reviews your contract against, what are considered as, the key essentials for a contract to be outside IR35.

You will receive a Pass or Fail only, with no clarification or details as to why.

You should remember that the contract represents only a small part of the assessment of your IR35 status. There is little point in constructing a contract to fall outside IR35 if it does not reflect the actual working arrangements that apply.

As this review is a contract only assessment it is unlikely to provide protection against HMRC applying penalties.

This is the sort of assessment carried out when applying for some form of IR35 insurance. You should check the policy conditions as often they are assuming that the actual working arrangements align to the contract terms; which they often don't. If there is a difference you could find any insurance void.

• **Assignment Review**

This review tends to carry out a full review of the contract as well as requiring you to complete a detailed questionnaire explaining your actual working arrangements with the end client.

It is widely regarded that to avoid the risks of penalties and demonstrate you have taken reasonable care in assessing your IR35 status a review needs to include a full assessment of both the contract and the actual working arrangements.

As the complete assessment covers both these areas, and where supported by a full conclusions report, this is likely to provide clear evidence that you have taken reasonable care in assessing your IR35 status and therefore avoid potential penalties.

This style of review, when carried out by a recognised professional firm, is likely to help HMRC conclude any IR35 enquiry in a timely manner.

Within the new enforcement regime one of the key questions asked at outset is whether you have considered your IR35 status and, if you have, providing evidence of any review carried out.

It is our belief that where the review has been carried out by a recognised professional firm and is fully documented, covering both the contract and working arrangements, then HMRC are more likely to accept this and move on; only time will tell if our expectations are actually met in practice.

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SUMMARY

If HMRC apply their enforcement strategy as intended then contractors cannot ignore IR35.

As more enquiries are opened and costs for insurers increase they are likely to require a higher degree of assignment review before accepting the risk. Which ultimately could actually do away with the need for the insurance.

Insurance premiums are likely to increase significantly with some insurers withdrawing from the market. If premiums go too high this could limit the appeal of the policy.

If you insure your IR35 risk you will need to increase the level of your cover each year; so the costs will also increase in line with these increases.

The cost of £50k of insurance today is around £350 per annum; you can expect an increase of around £100 per annum as your potential liability increases.

We believe the only way to achieve real certainty is to have a full professional assignment review on all your assignments, renewals and extensions. Where this is carried out by a professional firm it will include a full written report, support in responding to any HMRC enquiry, as well as the ability to provide the review to HMRC.

In the new structure HMRC are far more likely to drop an enquiry or investigation quickly where it can be clearly

demonstrated that a full professional review has been carried out. Having a review carried out by a firm recognised by HMRC as an expert will also help.

Professional Passport offers fixed cost assignment reviews; we work closely with Bauer and Cottrell as our chosen experts in this field. They are also well known as experts to HMRC.

You can have unlimited IR35 assignments reviews for a whole year for £199; we are also offering a 10% discount on this for a limited period.

The product has now been updated to include FREE defence on IR35 investigations for this new first stage.

Our Guardian Plus also now includes FREE defence all the way up to Tribunal stage.

ACTIONS

If you have a current insurance policy covering any potential check the terms to ensure you have complied and continue to comply. If you have any doubts contact the insurer directly, not a third party seller.

If your policy allowed you to apply without any formal assessment of your engagements ensure your assignments are meeting the terms of the contract; for example many will not pay if you are unable to provide a substitute. Whilst your contract may say you can if that is not the reality you are likely to find yourself unable to claim as you have not met the conditions of the policy.