10.7 Dealing with HMRC

10.7.1 Getting a Revenue opinion

HMRC has a specialist unit dealing with IR35 inquiries and in the author's experience the staff there are very professional. Contact details are at www.gov.uk/government/organisations/hm-revenue-customs/contact/ir35-enquiries. Note that an HMRC opinion will only be binding if "all the relevant information has been supplied"; this will not include cases where the contract between the agency and the client has not been submitted.

10.7.2 Rights of appeal

Where the taxpayer disagrees with a Revenue opinion the issue can be forced by asking HMRC to make a formal decision under the *Social Security Contributions (Transfer of Functions, etc.) Act*. This is a relatively simple matter under the private sector rules, but not so in the public sector as it will not generally be the Revenue that has made a decision that strikes the contractor as unsatisfactory. This will leave him with two alternatives, neither of them particularly appealing.

The first would be to sue the public authority, or intermediary, for the recovery of debt, in that a debt incurred under contract has not been paid in full (because tax has been deducted). There may well be contractual problems with this – for example, if there is a clause which says that the contractor agrees that the contract is within IR35 – and even if there are not, the case will fall to be heard in the County Court, whose judges will not be used to dealing with complicated status cases and who are unlikely to want to take on HMRC, even indirectly.

The alternative would be to write to HMRC under reg. 52 of the *Social Security (Contributions) Regulations* 2001 and apply for a return of contributions paid in error. There is a time limit of the end of the tax year following that in which the contributions were deducted, and a *de minimis* limit which currently stands at £303. HMRC are then obliged to return these contributions unless they first make a formal decision that in fact no error has been made (they can also, in their usual manner, pay up first and investigate

afterwards). Any such decision can then be appealed in the normal way.

This alternative will obviously not sort out overpayments of income tax, but receipt of the NIC money ought to put the contractor in a position where he can confidently show what he considers to be the correct income tax treatment on his self-assessment tax return, i.e. his employment pages will show a large quantity of PAYE deducted but no (or very little) income as compared with the P60, and he might have to show some dividend income instead. An inquiry is of course a virtual certainty. Note that his service company will have underpaid corporation tax, which will also need dealing with.

The main reason why neither of these alternatives is very appealing is that they will not give any return to the contractor or his company of the employer's NICs – they go to the fee-payer. As that is where 82% of the money is (by the author's calculation), the best advice to give to contractors is to make sure that they understand what they are being paid before they start, and that it is sufficient, or to turn the business away if it is not.

Law: SSCBA 1992, s. 19A; *Social Security Contributions (Transfer of Functions, etc.) Act* 1999, s. 8(1)(a), (m); SI 2000/727, reg. 6(4), 52

10.7.3 Interaction of IR35 and VAT

We saw at **1.5** that employed status is incompatible with the independence and being in business required for being chargeable for VAT. How does this work for IR35, where the relationship is akin to employment?

What follows is speculation, but in some circumstances it may well be worth trying as a means of mitigating a potential IR35 liability. HMRC's view (expressed in their IR35 guidance) is that:

> "Fees charged by a limited company or partnership for providing personal services remain subject to VAT, even when these services fall squarely within the IR35 rules. This is because it's still the company that is contracting to provide services to its clients and as such the supply remains within the VAT regime. VAT is charged as appropriate on any supplies and input tax recovery is subject to the normal rules."

There must be considerable doubt as to whether this is correct. The question arises as to whether the service company is making supplies "in the course or furtherance of any business carried on by him" (VATA 1994, s. 4), in a context where it is agreed that (if IR35 does apply) the individual behind the company would not be doing so if he had contracted directly with the client.

In support of HMRC's contention, it is true that there is case law that suggests that a company might be carrying on business in circumstances where an individual would not (a good summary of the issues can be found in *Salaried Persons Postal Loans v HMRC*).

However, VAT legislation, being European, has to be interpreted purposively and in accordance with the relevant VAT directives. Here there are two reasons for supposing that there is no business: firstly, the independence required by the directive is absent; secondly, a purposive construction may well allow one to pierce the corporate veil on this issue and look at the matter (just as IR35 does, in fact) as if the company did not exist.

That would not be the end of the matter as HMRC would doubtless say that giving effect to a claim for repayment of VAT would leave the service company "unjustly enriched" (as it was not the company's money in the first place), and so they are entitled to refuse this under VATA 1994, s. 80. However, unjust enrichment is also a European doctrine and the case of *Weber's Wine World* suggests that it is the payment of VAT, not the making of a claim for it, that constitutes unjust enrichment. In circumstances where one is not asking for a payment but a set-off against other taxes this might well not apply.

Of course this leaves the personal service company no better off, as anything that HMRC might not be able to claim in IR35 money would simply be owed to some other party (the client or the agency), and normally speaking a taxpayer has no right of set-off when it comes to taxes. However this is different in the case of insolvency, where set-off is automatic under rule 4.90 of the *Insolvency Rules*, and companies found to be operating inside IR35 when their owners thought otherwise will frequently be insolvent. In this way the liability would be to the agency or client, not to HMRC, and it may well be preferable for a company to be in the hands of an insolvency practitioner appointed by such a person,

rather than falling under HMRC's notoriously aggressive policy for cases like this.

Law: Directive 2006/112/EC, articles 9, 10; VATA 1994, s. 4, 80; SI 1986/1925 rule 4.90

Cases: *Weber's Wine World Handels-GmbH and others v Abgarben-berufungskommission Wien* (2003) ECJ C-147/01; *Salaried Persons Postal Loans Ltd v HMRC* (2005) Sp C 504; see also the Advocate-General's opinion at para. 45-49

Guidance: https://www.gov.uk/guidance/ir35-what-to-do-if-it-applies#calculate-vat-and-corporation-tax

10.8 Action to take

10.8.1 General preparation

The most important thing with IR35, as with any contracts, is to make sure that those contracts reflect the facts on the ground – in this case including the fact that there is a genuine intermediary. That means that the contract must be made with the company, not the individual: the author has not come across any instances of HMRC challenging a contract made with the individual, but understands that they are doing so with increasing frequency.

Secondly, make sure that the company opens a bank account and that money from the contract is paid into it. These two points are elementary: otherwise you will be left arguing that the individual is acting as some sort of agent for the company. This might work, but the Revenue is unlikely to be impressed and will certainly fight it.

Thirdly, if you can, avoid mentioning the individual's name in the contract.

It is not necessary for the personal services company to have a contract with the individual, and probably not advisable. If it does, this will be likely to be an employment contract: this would first of all bring the arrangements within the ambit of the minimum wage legislation, forcing the company to pay a higher salary to the individual than may be wished for; secondly, it would inevitably be a pointer towards employment (see, in particular, at **10.1.3**).

Fourthly, keep the evidence. Most readers of this book will be accountancy practitioners who are used to keeping records; your clients (as you will well know) will not. Evidence can come in many

forms, but with the ability to store all your records on your computer it is not difficult simply to retain key documents and file them in a system from which they can be recovered. E-mails can be particularly important here – do not delete any, for example, that might show a difference between your treatment and that of permanent employees. Keep timesheets too, as these will show when you are not working as well as when you are, and keep details of any speculative work done which can be a powerful indicator of being in business on your own account; also diary notes that might tell when you are working from home, or going out marketing.

10.8.2 When you get a compliance check

In many ways an IR35 compliance check is just like any other: as with all status inquiries it is rather less advisable than usual for your client to meet the inspector as there are a great many pitfalls. You need to be aware, too, that the inspector will very likely make arrangements to see the end client, and may not tell you that he is doing so.

One important thing, though, is that IR35 determinations can generally be reduced by claims for two things, and it is important to get these claims in on time. One is that, with there being a deemed salary, this will be eligible for deduction against the company's corporation tax profits. There is an obvious difficulty in that you will clearly only want to claim a corporation tax deduction once you know that you have lost the IR35 case, so it is a good idea to put a claim in on a provisional basis. This can only be done between two and four years after the end of the accounting period in question, but as HMRC will be able to go back six years it is important to put in a claim for the earliest years that you can as soon as you can. (HMRC have expressed the view in an email to the author that overpayment relief claims can be put in going further back in cases where there are HMRC challenges, citing s. 43C of the *Taxes Management Act*. As this section says that it only applies to cases where careless or deliberate behaviour is established it would be unwise to rely on it.) This will be a provisional claim for overpayment relief. Note also that as there is no actual salary, there has to be legislation to invent one for corporation tax as well as for IR35. This can be found at CTA 2009, s. 139. If there is any need to go back further than this, special relief will need to be applied for,

which is in effect discretionary and so should be seen as a last resort. The deemed payment always takes place on 5 April and has to be claimed in that financial year, unless the company ceased trading at an earlier point in the year. (In the author's experience the corporation tax inspectors may not be aware of this and will try to allow the claim in the year in which the IR35 amount is put through the accounts; this will effectively deny relief altogether in many cases and appears to be expressly ruled out by s. 139(3) and (4) of CTA 2009.)

Also, bear in mind that the PAYE part of an IR35 claim will not take account of income tax already paid, which since 2016 will not just be at higher rate. If so, relief is at hand under ITEPA 2003, s. 58, which has the effect of reducing the dividend and so giving relief to the company owner *in person*. A provisional claim for relief under this section needs to be made within five years from 31 January following the date of the deemed payment. This is not so pressing as HMRC can only go back four years in the case of PAYE unless they can assert carelessness, in which case it is six; however if not done in time once again special relief is the only solution.

Be also aware that, with agencies now reporting what payments have been made to personal service companies (see **8.5**), HMRC will have the tools to investigate all the people working through a given agency. Where there is any hint of this, those affected need to get together and pool resources to decide how to fight back.

An interesting article appeared on AccountingWeb in February 2008 by a former Revenue inspector who had been involved in some of the cases recorded in this book. He analysed four; two won and two lost by HMRC, and concluded that a great deal revolved around the credibility of the witnesses: in particular, in the two cases that HMRC won the judges had been impressed by the testimony of the end-client, whereas in the two that HMRC had lost, they had not. Counteract this by contacting the client yourself, in particular the people who actually know how the contract functions: in the two cases that HMRC lost their witnesses were simply too far from the action. A Tribunal is, other things being equal, more likely to pay attention to a line manager than to an HR person.

Law: TMA 1970, s. 43C; ITEPA 2003, s. 58; CTA 2009, s. 139

Article (in two parts): https://tinyurl.com/ybtnn8p4 and https://tinyurl.com/ydy28l2c