



## PCG Accounting FAQ's

### Completing the P35 and penalties – facts and fictions

This FAQ consider the following issues:

- What is the position regarding the P35 and the issue of penalties?
- If the Revenue have already failed one of your contracts what are the options?
- What if your contract has been failed by an independent reviewer?
- What about borderline cases?
- What are the options when you have not had any of your contracts reviewed?
- What is the position if you are confident you are outside IR35 or that you have already paid sufficient by way of salary?

### The P35

Businesses are required to complete and submit to the Revenue by 19 May a form P35, which sets out the salary paid in respect of each employee together with the PAYE and NIC in respect of that employee.

This year the form includes a new question, number 6, which asks:

***"6. Do the rules relating to payments for services provided through a Service Company or a Partnership apply to any of your business income?  
- If "Yes", is PAYE and NICs on the deemed remuneration included over the page or on any continuation sheets?"***

There is some confusion about how to answer this question. The first point to make is that the question is not asking, "does your business provide personal services to which the IR35 rules might apply?"

You are only required to answer yes to the question if you consider that you have carried out relevant engagements in the year. However, while technically the Revenue expects you to tick the box if any of the company's income was from relevant engagements the issue of whether you should have ticked the box and whether there are any sanctions the Revenue can take if you do not tick the box only arises where there underpaid tax on which penalties might arise.

Sarah Walker confirmed to us that:

*"There is no specific penalty for failure to tick either of the boxes on the P35, though penalties can be charged if the tax due on a deemed payment is not included in the return (except in the circumstances covered by the special arrangements for correcting returns before 31 January, which we have agreed)."*



## **Penalties**

For the tax year 2000/1 the Revenue have announced that no penalties will be payable if:

- The return (P35) is submitted by 19 May 2001
- It is stated on the return or in a covering letter that the service company legislation applies to the employer
- An amount is included in the return for the tax and NICs due on the deemed payment
- It is made clear in a covering letter that the amount is provisional pending finalisation of the deemed payment calculation
- A correction to the return and accompanying documents, notifying the correct final amount for the deemed payment and the tax and NICs due, is made by 31 January 2002
- Any additional tax and NICs due as a result of the correction to the return are paid by 31 January 2002

Penalties for incorrect returns will be charged where there is fraud or negligence on the part of the taxpayer. The penalties are based on the amount of extra tax that would be due if the Return had been submitted on the correct figures. The penalty can be 100% of the additional tax /NIC due. If there is no additional tax or NIC due then there will be no penalties even if the form was incorrectly completed to the extent that question 6 was not answered correctly.

However, at the recent Shout 99 seminar Steve Greenwell, tax director of Qdos and Dave Smith, MD of Accountax, who are both ex Revenue inspectors, said that in their experience the worst penalties they had seen levied, which involved cases of tax fraud involving six figure sums, were no more than about 65% - 75%. In their view under IR35, where any underpayment results from a reasonably held view that the contractor was outside of IR35, then penalties were likely to be small even if the box had not been ticked on the P35. They expressed the view that penalties were unlikely to exceed 10-20% at most and might not be charged at all when it was clear that the miss-declaration was based on a reasonably held view of the contractor's status, albeit one that proved to be incorrect.

## **What next?**

Contractors need to consider their position realistically. There are a number of possible scenarios to consider.

### **Revenue contract failures:**



If a contractor has already had contracts failed by the Revenue then they should consider if there are any new factors that the Revenue may not have been aware of when they reached their original opinion? This could include, for example, the fact that the contractor has had a number of contracts in parallel (i.e. simultaneously) or that the contractor has a history of self-employment style contracts in the past or since the original contract was reviewed.

While PCG has never advocated sending contracts to the Revenue in this case, as they are already aware of your situation, it is unlikely to make matters worse if you now send your contract back to the Revenue asking for it (them) to be reassessed in the light of the new information you are supplying. Ideally this request should be accompanied by concrete new evidence that could affect their original view. For example evidence of being in business on your own account – such as full details of all other work carried out, information on matters like advertising for work, tenders submitted and won or lost, losses incurred due to disputed invoices, evidence of matters like employer's and public liability insurance and professional indemnity insurance etc.

If the Revenue still fail the contract there is the option of seeking a formal opinion from the Revenue and then challenging that by appealing to the General or Special Commissioners. Appeals on contract reviews are not covered by the PCG's tax expense policy but PCG may consider supporting cases which it considers could assist in clarifying the status tests or in extending the boundaries.

Instead of approaching the Revenue again contractors could ask one of the independent expert reviewers to review their situation to get an objective view on their status. Again they need to make sure that all relevant factors are considered.

With regard to the P35 contractors need to decide how to respond. There are several issues to consider:

- The Revenue is already aware that they have failed at least one contract. If the contractor does not tick the yes box the Revenue will probably wish to investigate the case.
- The contractor could tick the yes box but state in a covering letter that they are still considering their position and awaiting confirmation from the Revenue (or elsewhere) of their status. They could pay a notional amount by way of a deemed payment leaving any balance to be dealt with when they have considered their position further. This leaves open the possibility of making an amended return by 31 January 2002 and making a further deemed payment at that time. Interest will be payable.
- If, after further consideration, the contractor concludes they are outside IR35 then they can submit a revised P35 stating that they consider that IR35 does not catch them. This should probably be accompanied by evidence as to why this is the case – such as the Revenue's own revised contract opinion or the conclusions of an independent reviewer.



- If the contractor has already drawn sufficient salary then the deemed payment calculation will result in a nil figure and no more tax or NIC will be due. Technically, they should still tick the yes box on the form P35. But as there will not be any additional deemed tax/NIC due then failure to tick the yes box on the P35 should not result in any penalties.

### **Failures from non -Revenue contract reviews**

Similar considerations apply here. If you consider that there is information that might have affected the opinion on the original review then you should contact the reviewer as soon as possible. You should ask if the information might have affected their opinion and see what they would charge to look at the case again. Bear in mind that as you are supplying new information such as additional contracts or if you are asking them to reopen an old file and issue a new opinion then this does involve them in additional work, for which it is only reasonable that an additional charge will be made.

Again depending on the results you need to consider whether you are still caught or not. If possible this decision should be made by 19 May in time for completing the P35 but it seems unlikely that the Revenue will take issue with any company that reports subsequently to 19 May that, after further consideration, they consider that IR35 catches them and that they are therefore making a deemed payment. The Revenue will charge interest but it seems unlikely that penalties would be claimed.

If as a result of further consideration the contractor considers that they have reasonable grounds for thinking they are outside IR35 then the P35 can be returned with no tick and no deemed payment would be made. No further action is needed at present provided there is good evidence of the basis for that conclusion.

### **Borderline cases**

Where contracts have been judged to be borderline cases contractors should consider how they can improve the situation. Again if there is additional information that they now think is relevant they can ask the reviewer to reconsider the case. They can also consider contacting the client and asking them to confirm in writing their understanding of the relationship – such as confirming that there was no mutuality of obligation, clarifying what control, if any, the client had, and confirming that it was not the client's intention to create any form of employer/employee relationship. Where other factors are balanced intention can be the deciding factor.

If this additional evidence is likely to be available then contractors may feel more confident in deciding whether to answer no to question 6.

### **No previous contract reviews**



Where the contractor has not had any reviews of their contracts they still need to consider what their position is. It is not a requirement that they have their contracts reviewed – certainly not by the Revenue nor by an independent reviewer. But they are expected to take “reasonable steps” and if there is any doubt about your status then taking independent advice would provide good evidence that you had taken reasonable steps to clarify your position.

Bear in mind that the PCG’s tax expense insurance policy, which covers the costs of an investigation by the Revenue (and Customs and Excise), will only cover you if you have a reasonable case. Having your contract reviewed is not essential but the insurers will seek to establish how strong your case is before agreeing to cover all the costs of defending your position.

### **Outside IR35 or already paid sufficient PAYE/NIC?**

If your contract(s) are outside IR35, based upon a review by the Revenue or an independent reviewer, then you can confidently answer question 6 “no”. If you are basing your opinion on your own assessment of the situation then you should try to document that you have taken reasonable steps to confirm your status. You need to be able to show what grounds you have for concluding you are outside IR35 – for example by setting out the key contract clauses (e.g. substitution, fixed price work, multiple simultaneous contracts etc etc) and any other relevant factors.

Alternatively you may know that some work is caught by IR35 but consider that you have already paid sufficient salary to cover any deemed payment that might be required. Here again in this case you may decide not to tick the yes box. While in theory the Revenue may argue that you should tick the box even if there is no requirement for a deemed payment there is no sanction for not ticking the box if there is no additional tax to be paid. It seems reasonable that, in the situation where you have already paid sufficient salary to cover any deemed payment, then you can argue that you did not see the need to spend additional time considering the issues any further.