Background information

Your role

You are a senior associate at Redwood Tax LLP, a firm of Chartered Tax Advisers. You act under the supervision of a tax partner. You have been asked to assist with advice for a new individual client who has recently received correspondence from HMRC.

Your new client

Alex Carter is an IT contractor who works primarily in specialist areas of information technology. Alex has worked in the IT sector for many years and has used a variety of engagement models over time. Alex has recently become concerned that his tax position whilst employed by Rain Ltd may not be correct.

Redwood Tax LLP has been engaged by Alex to advise him on his current HMRC enquiry, the historic position, and next steps.

Redwood Tax LLP has already carried out all necessary client onboarding processes for Alex in accordance with all relevant UK regulatory requirements.

Extracts from client file – employment with Rain Ltd

Working arrangements

From 6 April 2016 to 31 March 2024 Alex worked on various IT projects for clients of Rain Ltd.

The contractual chain operated as follows:

- Third party companies engaged a recruitment agency to supply IT contractors at an hourly cost set at the market rate.
- The recruitment agency in turn engaged Rain Ltd, an umbrella company, at a discounted rate reflecting Rain Ltd's assumed Income Tax and National Insurance Contributions (NIC) position.
- Rain Ltd employed Alex under a contract of employment and paid Alex via PAYE after the deduction of Income Tax and NIC.

Alex was generally expected to attend client sites during normal working hours, although some work could be performed remotely. Alex always reported into and was supervised by an employee of the client company.

Alex worked full-time on each engagement for extended periods at a single site.

Alex has never had a direct contractual relationship with any of the client companies or the recruitment agencies.

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Payments and PAYE operation

Rain Ltd paid Alex's monthly net pay after deducting Income Tax and employee NIC via PAYE. Employer NIC was also accounted for by Rain Ltd.

Rain Ltd operated a 'standardised' expenses model under which it assumed that 35% of Alex's gross pay represented deductible employment expenses that it was reimbursing. Income tax and NIC were calculated and paid to HMRC on the remaining 65% of gross pay.

Alex did not submit expense claims to Rain Ltd or provide it with any other evidence of the actual expenses or amounts incurred. Alex was told that the 35% figure was applied to all contractors employed by Rain Ltd and that this was "HMRC compliant".

Alex is not sure how the standardised expenses model operated or on what legal basis it was considered compliant.

Expenses treated as deductible

Using the standardised expenses model, Rain Ltd treated various expenses incurred by Alex personally, including the following categories of expenditure, as if they represented Alex's employment expenses for which the company had reimbursed him:

Travel costs

Daily travel between Alex's home and the client sites where he worked.

Occasional overnight accommodation when working late or during project deadlines.

Training costs

Online IT certification courses.

Some courses were undertaken before a particular engagement commenced with a client; others were undertaken during an engagement.

In determining its standardised expenses policy Rain Ltd made no distinction between different types of contractors, roles, locations, duration of placements with clients, or working patterns.

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HMRC correspondence

HMRC has written to Alex stating that it is reviewing Rain Ltd's operation of the PAYE regime in relation to Alex's employment income received from Rain Ltd for the tax years 2016/17 to 2023/24 inclusive.

We have yet to receive a copy of the letter from Alex. However, according to meeting notes of an initial discussion with Alex, the letter:

- states that Rain Ltd has ceased to trade following its insolvency;
- states that HMRC believes Income Tax and NIC may have been under-accounted for by Rain Ltd;
- states that HMRC intends to pursue Rain Ltd's former employees, including Alex, for the underpaid Income Tax and NIC;
- requests information about Alex's working arrangements and expenses; and
- refers to the possibility of Alex being liable to interest and penalties in respect of the underpaid tax.

Extracts from client file – employment with Z plc

On 6 April 2024 Alex started work as an employee of Z plc. He had never previously worked for Z plc in any capacity and Z plc is not connected with Rain Ltd or any of the recruitment agencies.

Z plc provides basic IT equipment such as a laptop, monitor and related IT peripherals for its staff. However, it also has a "bring your own" (BYO) policy under which it permits staff to bring their own devices to work to use instead of company devices if they prefer. Alex purchases his own equipment for his employment with Z plc and intends to replace it every three years.

Extracts from client file – future planning

Alex anticipates receiving a substantial sum in the next year which he intends to invest. He would like advice on how to arrange his affairs in a tax-efficient manner but is concerned about the extent to which tax planning is permissible.

Alex has specifically asked whether arranging his affairs to reduce his tax liabilities could be regarded as tax avoidance and, if so, how this differs from legitimate tax planning.

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