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New IR35 – will the Digital Tool be reliable?

Underpinning the forthcoming changes to IR35 in April 2017 is HMRC's new Digital Tool. We've heard a lot of promises from HMRC about how it will be all-singing, all-dancing, and that it will accurately reflect the case law around employment status. There are a number of IR35 cases mentioned in this newsletter and you can follow the hyperlinks to the text of the judgments.

HMRC have publicly acknowledged that agencies in particular would need ample time to implement the IR35 changes (which will also affect any existing public sector contract which extends beyond April 2017). HMRC also claim to recognise that the industry will need time to test a beta version of the Digital Tool, and that they themselves would need time to hone it based on feedback. Because of this HMRC promised the Digital Tool would be available well in advance of the introduction of the new legislation.

Unfortunately the unveiling of the Digital Tool has already been delayed, and the only official commitment in the guidance on the new legislation released on 5 December is that 'a version will be made public for testing before 6 April 2017'. It has been reported elsewhere that a public beta launch is scheduled for February 2017.

However, an 'alpha prototype' of the Digital Tool (officially now being called the "Employment Status Service" by HMRC) has already been made available, initially to the Freelancer & Contractor Services Association (FCSA).

The new Digital Tool is intended to be the backbone of the new measures and will provide a definitive and binding outcome for those paying PSCs. Given that after April 2017 the IR35 decision in public sector cases will commonly be made by agencies who generally are not experts in IR35, the accuracy and reliability of the tool is critical to its effectiveness.

Early analysis of the Digital Tool's alpha prototype reports that 'mutuality of obligations' – a key feature of an employment relationship – is assumed to be present in every case simply by virtue of the fact that the tool is being used at all. Apparently the Digital Tool makes the assumption that all arrangements, whatever their nature, necessarily contain the mutual obligations required for a contract of employment.

This will come as little surprise to those who have argued employment status with HMRC over the years. HMRC have an inflexible stance on mutuality of obligations (or MOO for short), as set out in their public guidance:

The significance of mutuality of obligation is that it determines whether there is a contract in existence at all. Without mutuality of obligation there can be no contract of any kind.¹

This has been argued many times by HMRC in the context of IR35 disputes. In response, it is almost invariably argued by the taxpayer that the mutual obligations required to establish an employment contract involve a higher degree of obligations than are necessary simply to establish a contract. It is inherent in an employment contract that the employer will offer some work (or at least pay a retainer) and the employee will be obliged to do that work.

Whilst there is scope for argument in a contentious dispute with HMRC, there should be none within the Digital Tool. Whatever HMRC's opinion of the matter, and whatever the taxpayer's, the Digital Tool professes to reflect the case law. So, let's look at the IR35 case law.

¹ Employment Status Manual, paragraph 0543

The vast majority of IR35 cases end up being settled by agreement without seeing the inside of a Tax Tribunal. Despite this, there is a fairly substantial body of case law in the relatively short history of IR35, with around 20 decided cases split right down the middle in terms of wins and losses for HMRC over the last 16 years.

Almost all cases begin and end in the First-tier Tax Tribunal (or the Special Commissioners of Income Tax as the tribunal was previously constituted) and are rarely appealed higher. Therefore the cases cited below (with one notable exception) are not binding. However the judges base their decisions on binding employment status case law precedent established over many years in higher courts.

It is abundantly clear from the cases won by the taxpayer that the tribunals commonly reject HMRC's notion of MOO in the context of the IR35 test. It is true to say that different tribunals have given a different characterisation to the test or have given a different degree of weight to that characterisation; although this is to be expected in a context- and fact-sensitive area of law.

To illustrate by example in the case of *First Word Software Ltd*² heard in 2007, the Judge Dr Nuala Brice stated that a relevant factor in the case was:

*"...whether there is mutuality of obligation so that there is an obligation on the worker to work and an obligation on the other party to pay him and to continue to make work available during the time of the contract"*³

This case involved an IT consultant, Neill Atkins, working on an IT project for Reuters known as Project Leapfrog. Dr Brice went on to find that Reuters would not have to find Neill Atkins any work to do, nor would they have to pay him if for any reason the work on Project Leapfrog was not available. She went on to state that:

*"...These arrangements point to the conclusion that Mr Atkins was not an employee of Reuters."*⁴

This is a particularly common theme in IR35 cases. In the *Primary Path*⁵ case in 2011 the Tribunal came to the same conclusion that Philip Winfield, an IT consultant working at GSK was not caught by IR35, partly on the basis that:

*"...the essence of the arrangement was that Mr Winfield was paid only for the hours he worked, and should at any time his strand of work within the overall project have suffered a hiatus for any reason, we cannot see that he had any contractual basis for demanding other work or payment whilst he waited for his work to resume. Nor is there anything to suggest that GSK had it in mind to offer work beyond the specific project for which Mr Winfield's services were engaged. This feature of his hypothetical contract we see as calling into question whether it is an employment contract – it is a feature which is more indicative of a contract for services."*⁶

Most contractors and agencies will readily recognise this feature of a freelance relationship – the parties are not bound together by any mutual obligations to offer and accept work, and a freelancer faces inherent uncertainties about availability of work which employees generally do not have to worry about.

Some Tribunals have gone much further and viewed the above position as not simply a pointer away from an employment relationship, but as being inherently inconsistent with one.

² [First Word Software Ltd v Revenue & Customs \[2007\] UKSPC SPC00652](#)

³ *Ibid.*, para. 59

⁴ *Ibid.*, para. 63

⁵ [Primary Path Ltd v Revenue & Customs \[2011\] UKFTT 454 \(TC\)](#)

⁶ *Ibid.*, para. 65

In the case of *MBF Design Services*⁷ the Tribunal rejected HMRC's argument that there was always work available and accepted that the design engineer, Mark Fitzpatrick, would be sent home without pay by Airbus if there was no work for him to do. The Tribunal held that there was:

*"...an absence of the mutuality of obligation needed for a contract of employment to exist."*⁸

Similarly, in *Marlen*⁹ the Tribunal noted that JCB employees remained at work being paid when the computers went down, whereas the contractor in that case was sent home unpaid. In addition (and typically of the freelancing sector), the parties could terminate the agency arrangements without consequence:

*"That this happened is not consistent with a relationship in which mutuality of obligations is present."*¹⁰

Finally, in the *ECR Consulting*¹¹ IR35 case the Tribunal expressed matters simply and plainly:

*"We do not accept that there was any mutuality of obligation."*¹²

In all of the cases mentioned above, the Digital Tool in its currently reported form would have assumed that there were sufficient mutual obligations to found an employment contract, and therefore would have likely provided an incorrect outcome. This is despite the fact that five of the ten cases that HMRC have lost on IR35 have all stressed the importance of MOO.

If the Digital Tool is to inspire confidence it must be based on the IR35 case law and not on HMRC's arguments about MOO – arguments which are often roundly rejected by the Tribunals. Failing to take into account the lack of MOO and the consequent inherent insecurity of being a contractor will likely result in the Digital Tool being consigned to the same fate as the existing online Employment Status Indicator, which is widely regarded as unreliable and biased towards employment.

Ultimately, if you (and your clients) want as much certainty as possible then the likely flawed Digital Tool will not provide it and you will still need to seek expert advice. You may have noticed that five of the ten successful cases were argued by our very own Matt Boddington and therefore if it is tried and tested advice you want then look no further.

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⁷ [MBF Design Services Ltd v Revenue & Customs \[2011\] UKFTT 35 \(TC\)](#)

⁸ *Ibid.*, para. 60

⁹ [Marlen Ltd v Revenue & Customs \[2011\] UKFTT 411 \(TC\)](#)

¹⁰ *Ibid.*, para. 42

¹¹ [E C R Consulting Ltd v Revenue & Customs \[2011\] UKFTT 313 \(TC\)](#)

¹² *Ibid.*, para. 41