TaxZone Newthwire

Issue 83 – 22 August 2005 Employment Status Issues

Available on subscription at:
http://www.accountingweb.co.uk/premium_content/newthwire

Contents

(1) Introduction

The fact that self-employment is not defined in the Taxes Acts or other law continues to spawn cases that proceed to the Commissioners and the courts, and regularly exercises the minds of accountants whose clients may be in a 'grey area'.

Whether such lack of definition is deliberate or not is hard to say. The whole issue is a complex one, as an increasing number of employment law cases are being heard by the tribunals, and decisions are being made that appear to conflict with existing tax case law and tribunal decisions.

The consequence of all this is an extremely confused situation, where it seems that every disputed case must be decided on its own facts.

I had hoped that the HMRC paper 'Small Companies, The Self-Employed and The Tax System' would shed some light on this 'minefield' but I was sadly mistaken. Neither did the ICAEW Tax Faculty paper TAXREP22/05, under the same name, clarify matters to any degree.

I shall therefore, in this wire, seek to summarise where we are now, review the latest court and tribunal decisions and spend some time reviewing the many 'Any Answers' queries on this subject.

(2) IR 35

The subject of employment status is inextricably linked with IR 35, as all the IR 35 cases that have been heard by the Commissioners and the courts up to now have been fought on the grounds of whether the owner of the personal service company would have been self-employed or employed, without the interposition of the company.

These cases have been summarised in previous wires, which include:

Issue 4 – 24 June 2002 – Employed or self-employed?
Issue 14 – 11 November 2002 - Hope for IR 35
Issue 33 – 18 August 2003 – IR 35 and Status update
Issue 65 – 24 November 2004 – IR 35 case update

(3) Recent cases

I do not intend to discuss in detail the cases that have been reviewed in previous wires, but comment on the most up-to-date ones. These are:

Future Online Ltd v Foulds [2005] STC 198

The High Court confirmed the decision of the Special Commissioners that the contracts came within IR35, and the taxpayer owner of the company was therefore adjudged to be, effectively, employed.

Netherlane Ltd v York SpC 457

This was another case concerning national insurance contributions and a computer systems specialist who operated through his personal service company. The case prepared by Mr Renshaw's accountant ran to 74 pages, and that of HMRC to 25 pages. The personal service company, through an agency, obtained a contract with a life insurance company for consecutive 26-week periods.

As in similar cases, the contract was headed 'contract for services'. The appellant would give priority to the work of the client company and specified an obligation of '5 professional working days' a week. It became clear that Mr Renshaw was under the control and management of NPI, which was no doubt fatal to his case, and he was also designated team leader or project management leader. He was required to report to a named manager. Pay was made on the basis of a timesheet and was made at a rate per working day. The contract was terminable by NPI on four weeks' notice. The appellant had been employed previously for 18 years by a life insurance company.

The Special Commissioner, Dr John Avery Jones, confirmed that the legislation required him to establish the terms of a hypothetical contract between Mr Renshaw and NPI. He considered that mutuality of obligation was satisfied by NPI's agreement to pay a certain rate of pay per working day. There was no credible right of substitution. Mr Renshaw had no other clients at the time of the contracts. Subsidiary issues were that Mr Renshaw provided his own laptop and mobile phone and he received no employee benefits. However the Commissioner held that he was clearly 'part and parcel of the organisation'.

In dismissing the appeal the Special Commissioner observed that more actual evidence regarding the practical outworking of services supplied would be helpful in similar cases.

Bridges and others v Industrial Rubber plc [2004] UKEAT/0150/04

Just to make us all even more confused the decision of The Employment Appeal Tribunal in this case held that, for a relationship of employer and employee to exist, there must be mutuality of obligation and that mutuality of obligation means that the employer has undertaken to provide work and the employee has undertaken to do it.

If there is not a promise to provide work and the counter promise to do it there is no contract of employment, whatever the circumstances of the case. This case concerned outworkers whose contract stated that 'for any pay reference period the company shall be under no obligation to offer work and the home-worker shall be under no obligation to accept work from the company'. Accordingly the claims of the workers for unfair dismissal and/or redundancy pay failed.

The decision in this case completely contradicts the view of HMRC that all that is necessary for mutuality of obligation to exist is that 'the engager must be obliged to pay a wage or other remuneration and the worker must be obliged to provide his or her own work or skill'. Reference can be made, in this connection, to the Employment Status Manual at paragraphs 514 and 1071.

It can be seen that, although mutuality of obligation was only part of the issue in *Netherlane*, the decision of the EAT in *Bridges* also contradicts the view of the Special Commissioner in *Netherlane*.

Bunce v Potsworth Ltd trading as Skyblue [2005] EWCA Civ 490

This was an employment law case concerning a welder who, through an agency, worked for rail track companies. His appeal against unfair dismissal as an employee was dismissed in the Court of Appeal. The court upheld the finding of the tribunal that the lack of mutuality of obligations between the agency and the individual was fatal, and apart from this factor the agency did not exert sufficient day-to-day control in order to make Mr Bunce an employee.

Lord Justice Keene articulated what many feel when he stated 'what is clear is that there is now a large and growing number of people in full-time or nearly full-time work who, because they work under agency arrangements, do not enjoy the full range of employment rights conferred under the legislation on those working under more conventional arrangements'.

(4) Re-categorisation

Why is HMRC so keen to re-categorise workers as employees, and why are some employers so ready to go along with this objective? It seems to me that, in disputed cases, the HMRC view is that:

Inspectors are aware that re-categorisation as an employee will produce Primary and Secondary Class 1 national insurance contributions, effectively a tax whatever the government says. There is less of a 'take' from Class 2 and Class 4 NIC. Self-employed earners also have more scope for claiming allowable expenses for tax purposes.

Individuals taxed under PAYE are effectively under government 'tax control'.

In many instances it is not necessary for an employed earner to complete and submit a self-assessment tax return. There is a substantial administrative saving, as most of the PAYE administration is completed by the employer.

Employers, particularly larger firms, may not want to become involved in disputed cases, and may have already undergone a PAYE audit. From their perspective it is easier just to make the individual an employee. This may not be the correct decision from other perspectives, as the individual then obtains employment rights.

Having said this, clients who say that they are 'going self-employed', yet still work for the same sole business on roughly the same terms are clearly abusing the system.

(5) Current Issues

There is a well-know list of badges of trade, which are supposed to support a claim for self-employment or demonstrate that fact. I say 'suppose', because in some tribunal and other cases the Commissioners and judges appear to have overlooked the importance of these badges of trade to one degree or another.

In fact, if one analyses the many 'status' cases that have gone to appeal, what emerges is that no one issue is definitive, and individual judges or Commissioners may take a different view to each other in broadly similar cases.

This is a depressing and confusing fact. Nevertheless it is important to highlight those 'badges of trade that appear to be important at present when cases go to appeal.

Planning Point

Practitioners should try and advise clients contemplating self-employment before they actually begin self-employment.

The overall view

The overall perception of the business carried on by the taxpayer, and his or her intention to be self-employed should carry substantial weight.

Contracts

Where contracts are involved in a business relationship, the terms of the contract and whether or not its provisions are carried out in practice are important.

Planning Point

A contract for services is a vital document. Every accountant should have a draft contract available, and be able to advise potential clients of the comprehensive provisions that should be in such a contract.

Control

The ability of an individual to carry out the trade or profession in the way that he or she chooses is a good sign of self-employment. A number of IR 35 computer consultant cases have failed at this hurdle because of the element of control exercised by the client company, and the fact that the individual had to report to a named individual and/or complete a timesheet.

Substitution

The tribunal in one case stated that an individual 'cannot' be an employee if there is a valid right of substitution. Ever since HMRC have been trying to undermine this principle. However, if the individual is able to provide a substitute, chosen by him or her, and not dependent on approval by the client, then this is still la good factor pointing towards self-employment.

Mutuality of Obligation

HMRC don't like this principle, and, as stated above, have their own views on how the principle should be applied. Some tribunal chairmen and judges have gone along with this, and others have not. It is still an important principle that should be highlighted in suitable cases. How can an individual be an employee if the client is not obliged to provide him or her work, and the individual has the right to accept the work or refuse it?

Part and parcel of the organisation

In several IR 35 cases the individual has worked at the client company's premises and has been, in many ways, indistinguishable from employees who work for the organisation. This has proved to be unhelpful in attempting to prove that the relationship was one of self-employment.

Other clients

The fact that an individual has a portfolio of different clients is a strong indication of elf-employment.

Subsidiary Issues

Other factors that may or may not assume importance in particular cases include:

(1) Evidence of being in business on one's own account.
(2) Evidence of the taking of business risk.

(3) Provision of equipment.
(4) Length and number of engagements and exclusivity.
(5) Payment terms and method of payment.
(6) Provision or not of benefits.
(7) Rights of termination.
(8) Absence or not of holiday entitlement and holiday pay.

Planning Point

Keep your own record of badges of trade for all clients who are in a 'grey area' and could be challenged by an HMRC status inspector.

(6) A Practical Illustration

The following recent case concerned an employment status review suffered by a large scaffolding organisation that engaged self-employed subcontractor scaffolders. I am indebted to Sean Wakeman and Numerica LLP for permission to include the details.

Had the subcontractors received a letter of the type recently sent out to 55,000 subcontractors, they would probably have answered 'yes' to two of the six 'loaded' questions included in that letter.

However, in this instance the case began by the inspector meeting the owners of the scaffolding business to discuss the terms of engagement with the scaffolders that they used.

Numerica LLP were retained by the business at an early stage, and the usual lengthy correspondence ensued regarding 'badges of trade' and decided tax cases. As deadlock with HMRC was reached counsel's opinion was sought. This supported the view that the scaffolders were correctly designated as self-employed.

Despite counsel's opinion regarding the lack of control and mutuality of obligation HMRC persisted in their case and raised regulation 49 determinations and NIC decisions. An application was then made to have the case heard by the Special Commissioners, and counsel went as far as drafting skeleton arguments and performing much other background work.

However, at the 11th hour HMRC conceded the case. Had they lost it in a public arena it would have caused industry wide precedents and repercussions within the building industry. Conversely, had the scaffolding business lost the case, it would have had to pay nearly ½ million pounds, which would have put it out of business.

This case has startling similarities to a case I took several years ago, the only differences being that my case did not concern the building trade and counsel had not completed as much work before HMRC conceded defeat.

These cases illustrate once again that where the facts are favourable, there are substantial amounts of money at stake and the client is willing to pay the costs, it is important to fight 'grey area' cases very hard, and not to be deterred by HMRC rulings. This is not to say that one should appeal to the Special Commissioners frivolously. However, where an appeal is listed and HMRC know that they might lose the case, they are likely to concede because of the subsequent publicity if they lost.

Planning Point

Do not concede to HMRC easily in cases where you and the client are sure of the facts. An appeal to the Special Commissioners may 'call HMRC's bluff'.

(7) Any Answers

Not surprisingly, queries about status issues are a regular feature on the 'Any Answers' site. A selection of these are considered now.

Employment status question 133362

Brian asked a question about a microbiologist client on 14 November 2004. The client in question works mainly for two private hospitals and has fallen foul of an Inland Revenue status enquiry that was not communicated to the adviser. Unfortunately he returned the HMRC questionnaire without contacting his adviser.

Without commenting on the facts of this case, which indicated self-employment to me, the factor to emerge from this case was that clients *must* tell their advisers if status inspectors approach them. Any questionnaires should only be submitted after good professional advice.

CIS Employment Status Letters 129696

Cathy Ratchford enquired about letters that are being sent to main contractors and subcontractors, in her query of 16 August 2004. As I understand it there are six 'loaded' questions in the letters sent to subcontractors.

Both 'Mike' and David Heaton suggested that it would be wise to review the situation for each subcontractor before HMRC took any further action. Each case depends on its own facts, and computer driven questionnaires may well have come to the wrong conclusion.

Employment Status reasoning 128336

Brian introduced a case where the client had dealt with an employment status enquiry form without reference to him, in his query of 10 July 2004. The inspector had made a ruling that the client was employed, a decision with which the adviser did not agree. What can be done now?

As I stressed at the time, the client is at fault here. However, all is not lost if the client wishes to fight the decision, and has the funds to do so. Re-negotiation with the inspector would be a starting point. Self-employed accounts and tax returns could be submitted. Ultimately the Commissioners and courts have to decide the issue.

Status enquiry – error by the Inspector? 126076

Daren Peacock mentions an oft-repeated situation in his query of 6 May 2004. An HMRC status enquiry concluded that a client was employed, but the question of 'control' was not addressed. This was despite the statement in the Employment Status Manual at ESM1013 that 'where an engager has no right of control, there will not be a contract of service'.

This query highlights the annoying habit of HMRC, tribunal chairmen and judges of ignoring, when it suits them, important relevant statements made about status in some instances. Respondents made some good points about control, but in the end it is up to Daren and his client as to whether they want to fight the case further or not. Do they have the time, funds and determination to do so?

Do sub-contractors have a special concession from IR in respect of status? 17196

'Fred' asked this one on 1 September 2003. Paul Soper replied unequivocally 'no', and added that the onus was on the 'employer' or client company. If the HMRC challenged status, it was the main contractor who would undoubtedly have to pay any PAYE tax and NIC found to be due. In the past HMRC often

turned a blind eye to one man labour only subcontractor abuse, but this has now been radically tightened up.

Self-employed status of performers 105913

Philippa explained, on 19 March 2003, that a client was intending to put on improvisational dramatic performances. They will be working for a short period on this project, and include lighting and sound technicians, performers and a director, all of whom are registered as self-employed. Is there any vulnerability of self-employed status in this situation?

Stanley Harvey rightly commented that the client must obtain the current tax reference for each person involved, not just their NI number. I would have thought that, as the people involved are already registered as self-employed, there was little danger of HMRC attack in this instance.

Can a locum be self-employed? 131087

A Wells queried this one on 22 September 2004, in relation to holiday cover for a conveyancer in a solicitor's office. Paul Garbett disclosed that he had plenty of GP medical locum clients, who were still being accepted as self-employed. Normal status rules will apply. There is probably an element of control, but a lack of mutuality of obligation.

Self-employed status guidelines 126762

Jenny gave a speech as guest speaker for an organisation and subsequently invoiced them for an agreed amount. The finance department of the organisation have now asked her to complete a form with all sorts of questions based on IR guidelines. She asked, on 26 May 2004, for any comments.

I commented at that time that this was an appalling discourtesy by the organisation. One suspects that they are 'covering their back', possibly due to a previous PAYE Audit. As Phil Rees rightfully pointed out, this request is 'rubbish'. The issues of substitution and mutuality of obligation make quite clear that Jenny was operating in a self-employed capacity.

Status enquiry 123820

Daren Peacock, on 4 March 2004, highlighted the case of a worker who had a previous ruling in 1996 that he was self-employed for the years 1987-1994. Another Inspector has now had a meeting with the client company (without Daren's knowledge) resulting in the issue of regulation 49 assessments on the client company for later years. Advice on this issue was requested. I would add that this is another instance where clients must be persuaded to communicate with their advisers before damage is done.

Steve suggested that reference was made to the Employment Status Manual at ESM0005. HMRC is obliged to help taxpayers get their affairs right, and if the facts were honestly presented on the previous occasion and the inspector then gave an opinion and the facts have not changed, then the client company is entitled to rely on assurance given

Paul Dorrington suggested that Accountax Consulting Ltd be approached to assist in this case.

(8) Conclusion

What can one conclude from the above material? The conclusion is that the fact that self-employment is not defined in tax or other law works in favour of the HMRC. The department is quite happy, with its vast resources, to treat every case on its own facts and merits, and to force taxpayers and their advisers to do the same.

This makes life very difficult for accountants and their clients, particularly when the client has minimal funds. The temptation is to give in on commercial grounds and allow HMRC to win, even in cases where

the facts do not suggest this. This is all wrong, but is a situation that we must all face until changes are made.

Ask a question

Readers with a current case should post their query in Any Answers.

JOHN T NEWTH
http://www.accountingweb.co.uk/premium_content/newthwire

TaxZone, 100 Victoria Street, Bristol, BS1 6HZ
Tel:+44 117 915 9600 Fax:+44 117 915 9630
http://www.taxzone.co.uk