

Analysis

HMRC's defeat in *Albatel*: the IR35 puzzle

Speed read

Employment status within the context of IR35 is a complex and shifting area. *Albatel v HMRC* highlights the key factors that need to be considered, with 'control' by the end user on how the services are provided now appearing the most prominent. Recent cases also highlight HMRC's approach to assessing IR35 through the use of its enquiry powers. Determining employment status will become increasingly important with the expected off-payroll working legislation taking effect from April 2020.



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We are approaching the 20th anniversary of the original 'IR35' announcement. In this article, we discuss potential income tax and NICs assessed under the 'intermediaries legislation' ITEPA 2003 ss 48–61, and the Social Security Contributions (Intermediaries) Regulations, SI 2000 (commonly known as IR35). The issue of 'deemed employment' via personal service companies (PSCs) is at the forefront of recent coverage in both the tax and non-tax media. One reason is a number of high profile cases reaching the tribunal. We consider the implications of these decisions, as well as cases involving individuals not readily in the public eye.

Recent IR35 cases involved the TV presenters Lorraine Kelly (*Albatel Ltd v HMRC* [2019] UKFTT 195) and Christa Ackroyd (*Christa Ackroyd Media Ltd v HMRC* [2018] UKFTT 69); an IT contractor (*Jensal Software Ltd* [2018] UKFTT 271); and a surveyor (*MDCM Ltd* [2018] UKFTT 147). A further case involving directors with PSCs (*Petrol Services Ltd* [2018] UKFTT 773) did not consider IR35 due to the contractual and payment relationship between the relevant parties.

Whilst we have not considered the implications of the latter case, it is a good reminder that IR35 is only relevant where an individual is engaged through a PSC and payments are made via the PSC. In those cases, any liability under IR35, if an employment was deemed, would arise on the PSC and the worker (assuming the rules specific to the public sector do not apply). If there is a direct relationship between the worker and end user giving rise to an employment relationship, IR35 would not apply and HMRC would seek any PAYE/NICs due directly from the end user.

Ultimately, the fundamental condition for IR35 to apply is the existence of a deemed employment relationship between the worker and the end user. The consideration as to whether an employment would exist applies the usual badges of employment (especially the irreducible minima of control, personal service and mutuality of obligation). Consequently, IR35 fits into the wider dialogue on employment status following recent high profile worker rights cases, as well as Matthew Taylor's report on the future of work, the 'Good work plan' (see bit.ly/2Gjg3ar).

Lessons from the cases

Whilst there are clear factual differences between the four cases, a theme running through them is control.

In the three cases which the contractors won, their success centred on demonstrating to the tribunal that they operated under little or no control from the end client. Lorraine Kelly's appeal (*Albatel*) relied mainly on the absence of control by ITV on how she presented her show. The contractor in *Jensal* was held to be an expert in his field, so the end client was unable to control how or where the work was undertaken. While in *MDCM* it was held that there was some control, in effect this amounted only to setting out the scope of work to be undertaken, which was delivered without supervision by the end client. The only other control was that imposed by health and safety legislation while operating on a construction site.

By way of contrast in *Christa Ackroyd Media (CAM)*, the tribunal agreed with HMRC that the BBC controlled how she presented the relevant programmes and how she provided her services. Consequentially, the tribunal decided that IR35 applied.

While the HMRC's success ultimately rested on the issue of control, the cases also provide useful guidance on other factors, particularly mutuality of obligation and personal service.

Mutuality of obligation

This is an area that some in the profession perceive HMRC is unable to properly grasp. HMRC's opinion is that the mere existence of a contract, with payments being made under it, is sufficient to demonstrate mutuality of obligation. However, that view ignores the reality that mutuality of obligation for employment purposes relies on the fact that the 'employer' will offer work to the 'employee' and the 'employee' will accept that work.

Jensal noted that agreeing work and being paid for it simply demonstrates an existence of a contract, by quoting from *Usetech v Young* [2004] All ER (D) 106: 'Mutuality of some kind exists in every situation where someone provides a personal service for payment, but that cannot by itself automatically mean that the relationship is a contract of employment: it could perfectly well be a contract for freelance services. Similarly, in *Albatel* it was noted that despite the contract and an expectation of 42 weeks' work per year, if Kelly's ratings fell, ITV could easily cancel the show.

In any event, these cases show that mutuality of obligation is less significant than control. *CAM* concluded a deemed employment was in place but the FTT stated that mutuality of obligation was a neutral factor.

Personal service

In the cases considered above, it was accepted that there was personal service with limited or no opportunity for the worker to provide a substitute. However, this was not the determining factor in any of the cases. Historically, greater weight was put on substitution clauses in determining

employment status. Now, while many consultancy contracts allow for subcontracting, unless that actually happens in practice, the provision will be overlooked. Consequently, the opportunity to send a substitute is now considered less important than, for example, when *Ready Mixed Concrete* [1968] 1 All ER 433 was heard.

Check employment status for tax

Whether an employment is deemed is not simply a tick box exercise of totalling factors indicating for and against. Instead, taxpayers need to (paraphrasing *Hall v Lorimer* [1994] 1 WLR 209) 'paint a picture'. However, HMRC appears increasingly keen to reduce employment status to a checklist. For example, *Jensal* made frequent references to HMRC's reliance on its status questionnaire. As the use of HMRC's check employment status for tax (CEST) tool becomes more widespread, 'questionnaire' in this context could be read as a proxy for CEST.

While this article does not critique CEST's strengths and weaknesses, it is worth noting that putting *Albatel's* facts into CEST would result in employment being deemed, which is contrary to the FTT's decision. Clearly, CEST is an evolving program; however, as it is HMRC's preferred method for businesses to determine employment status and will become even more prevalent from April 2020, it appears that adjustments are needed to reflect these rulings.

HMRC's approach to IR35 enquiries

In practice, HMRC's current process for challenging PSC status using IR35 is to open an 'employer compliance check'. This has no statutory basis. Unlike TMA 1970 s 9A for personal tax return enquiries or FA 1998 Sch 18 for corporation tax return enquiries, this 'employer compliance check' is solely HMRC terminology, based on its internal guidance. Consequently, the process is much curtailed and faster compared to the average self-assessment enquiry.

In many cases, there are a few rounds of correspondence asking for contracts and responses to generic questions. HMRC then issues a 'decision letter' confirming its view that IR35 applies. Usually, HMRC simultaneously issues determinations for PAYE and NIC. The decision letter and determinations then need to be appealed within the 30 day time limit (TMA 1970 s 31A). This modus operandi is heavily skewed towards HMRC in terms of powers and procedures. In some cases, FA 2008 Sch 36 formal information notices are used to gather information for the HMRC decision letter.

Albatel also highlights that HMRC uses interviews with broadcasters and end users to justify its IR35 decisions. The case decision seems to warn against heavy reliance on HMRC's meeting minutes; they are no substitute for first hand witness evidence, which the judge held in higher regard.

Practical issues

Counsel for the appellant highlighted the fact that *Albatel* existed since 1992. Fourteen years elapsed after the introduction of IR35 in 2000 before HMRC questioned the status. This period included an enquiry into *Albatel's* 2009 tax return that was closed without amendments. The burden of proof in the tribunal rests with *Albatel* and the standard of proof is the balance of probabilities.

The case flags the reality that PCs can be used for many years (over a decade) without challenge. From a layperson's perspective, it appears that HMRC accepted its operation, or at least 'turned a blind eye'. After all, this UK company filed accounts and tax returns and its shareholder filed returns

too. It is easy and straightforward for HMRC to identify and investigate such cases with full knowledge of the numbers, regardless of someone's fame.

Albatel won its FTT case, so it does not have the practical issue of IR35 deemed payment calculations (assuming HMRC does not appeal). In practice, where HMRC wins or the taxpayer concedes that IR35 applies, then the application of the legislation is not necessarily straightforward.

In most circumstances, PSCs pay corporation tax on profits and individual shareholders pay income tax on dividend distributions. If IR35 applies, the positions of the company and the individual need revising by:

- HMRC assessing PAYE within standard time limits (TMA 1970 ss 34 and 36) due to Reg 80(5);
- calculating profits chargeable to corporation tax, taking into account the deemed employment income, PAYE and NICs and differences between accounting periods and tax year end dates;
- claiming overpayment relief for corporation tax within the four year time limit (TMA 1970 Sch 1AB);
- recalculating the individual's position now that the income is emoluments and considering what happens about dividends declared previously, for which the company no longer legally has reserves due to the retroactive restatement of earlier years' results; and
- computing late payment interest, and whether this applies to the gross payment or the net payment after tax relief is given.

The lack of HMRC guidance and examples, particularly for computations, claims for relief and timing issues, is stark.

Off-payroll working in the private sector

The responsibility for determining employment status and the obligation to operate PAYE/NIC if IR35 applies will shift from the PSC to the end user from April 2020. There will be no appeal process between the end user, the PSC and the individual. It seems inevitable that this will lead to more tax disputes. In the absence of an internal appeal mechanism, these disputes are likely to involve HMRC and ultimately the tax tribunals. Without addressing inconsistencies, given the high level of subjectivity, results may lack the fairness expected in our tax system.

Summary

There are repeated calls, including from the industry bodies and the ICAEW, to delay the rollout of off-payroll rules to the private sector. All potential private sector 'employers' need clear guidelines that are objective and easy to apply in order to get labour categorised correctly as either employed or self-employed for tax purposes for these new rules. Until such time as the guidance exists and a dispute resolution mechanism is put in place, we would reiterate calls for this rollout to be delayed beyond April 2020.

In summing up its decision on control, the FTT was satisfied that Kelly was not part of the ITV jigsaw: 'Ms Kelly was the jigsaw.' For other individuals with onerous, long running IR35 enquiries the puzzle continues. For businesses preparing for the launch of the off-payroll rules, be prepared to be puzzled! ■

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