



## IR35 – level pegging in the courts

In the last two months, we have had four IR35 cases judged by the tax tribunals. Considering we have had less than a dozen cases reaching the tax tribunals in the last seven years, this has certainly given us an idea of where the law on IR35 stands today. With these four cases ending in a 2 all draw between the taxman and freelancers, we have taken a critical look at what decided the cases and summarised it here in a format that will hopefully provide guidance for those seeking clarity in their IR35 tax status.

The table below lists the 4 cases, along the top, against the judgements on the validity of the employment indicators as listed down the left column.

	Taxman vs			
	<u>MKM</u>	<u>Dragonfly</u>	<u>First Word</u>	<u>Datagate</u>
<u>Issues judged:</u>	Caught by IR35	Caught by IR35	IR35 Exempt	IR35 Exempt
Right of Substitution	None	None	Valid	Valid
Employer Control	Yes	Yes	No	No
Employment MOO	Yes	Yes	None	None
Contract Intentions	Dismissed	Dismissed	Unknown	Considered
Business Characteristics	Weak	Strong	Strong	Weak
<u>Judged by:</u>	Charles Hellier	Charles Hellier	Dr Nuala Brice	Adrian Shipright

### Right of Substitution

The right of substitution was looked at in detail in all the cases, and its validity was instrumental in each result. What is apparent is that there must be a right of substitution, or subcontract, in the agreement between the agent and the client. This appears to be more important than in the agent and contractor agreement as, if the client does not allow it at the top end of the contract chain then that is the end of the story.

Freelancers working through agencies must ensure that the contract between the client and agent allows for this, and should use all their persuasive skills with the client to ensure it is in place. Clients do not want employment relationships and are always sympathetic to this even where agencies may be apathetic.

### Employment Controls

We have learned very little new on the right of control from these cases. If the client controls the freelancer as an employee, then case law indicates that this is an important pointer



towards an employment relationship and IR35 taxes. If on the other hand the contractor determines the works schedule, programme and when segments of work are carried out, this is less like being a servant of your employer and more likely to fall outside of IR35.

Following the release of these IR35 cases, we have had an even more important judgement on employment status in *James v Greenwich Council*. In this case, the judge found that even though there were strong employment levels of control on the individual, they did not have an employment relationship with their client.

Case law has always suggested that for an employment relationship to be in place, all three pillars of the right of substitution, control and MOO must be in place. If one of the pillars is broken, then an employment relationship (and IR35) cannot be in place, which is now re-affirmed by this court case, one which HMRC must take heed of in making IR35 challenges.

## Mutuality of Obligation (MOO)

Despite its complicated name, this determinant of the relationship is quite simple. If the client is obliged to provide work and pay throughout the contract period, then that is an employment characteristic. If on the other hand, the client can terminate when the project is done, without notice or other payments, then that is more akin to a business relationship outside of IR35. This definition of MOO has recently been affirmed in the important employment law case of *James v Greenwich Council* heard initially at employment tribunal and more recently affirmed at the Court of Appeal.

In the IR35 cases of MKM and Dragonfly, the judge Charles Hellier particularly investigated the MOO and what constituted MOO. He found that in both cases it appeared that the client continued to provide work to the freelancer and pay even if their specified project tasks were completed. He determined that as the roles were a continued allocation of works by the client, so they were akin to a fixed period of employment rather than a self employment relationship.

In the other two cases the judges found that if the project work had dried up, then there would be no work and no further pay for the contractor, even if it was within the agreed start and end date of the contract.

Our advice to contractors in doubt about their IR35 status is to clarify this position with their clients and to ensure that they have contract documentation that states that if there is no work within a period of contract, then they will not be paid.

## Parties' Intentions

The intentions of the client and contractor as to the nature of their relationship were also discussed in three of the cases. This has recently become highlighted as an important determinant in the relationship. In the HMRC wins, Charles Hellier in judgement dismissed the intentions and considered the characteristics of the relationship as being a reflection of the parties' intentions.



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The findings of the judge in Datagate on the intentions should however be quoted as the first line of IR35 defence for any contractor. It was the last point he made in his decision and one that is fairly unambiguous -

“The intention of the parties seems to have been that there should be no employment. Why else would this structure have been set up? I find as a fact that the parties’ intention was that there should be no employment”!

## Business Characteristics

From the table above, it is apparent that the business characteristics were less critical in determining the IR35 result. In particular in the Dragonfly case, the contractor bought his own computers and other IT kit, paid £400 for his own training as well as providing his own chair at the client site!

Whilst there are plenty of employment status court cases showing the importance of genuinely being in business, it appears here that the other characteristics of employment classification are dominant.

## Nasa Consulting Summary

In summary of the cases, if there is a right of substitution between the agency and client, and if there is no guarantee of work throughout the period of contract, then the freelancer is indicating that they are outside of IR35.

These two characteristics are actually quite typical of a freelancer relationship through an agency with an end client and swing the IR35 argument quite heavily in the freelancer’s favour.

HMRC will also find IR35 more difficult to impose as these issues have been affirmed by the Court of Appeal in *James v Greenwich Council 2008*.

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