IR35 FOR THE PRIVATE SECTOR: PERSPECTIVES FROM EMPLOYMENT LAW AND TAX

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INTRODUCTION

The 'IR35' rules, introduced in 2017 were designed to prevent the avoidance of tax and national insurance contributions (NICs) through the use of personal service companies (PSCs) and partnerships. The rules have been in situ since April 2017 for PSCs who provide their services to the public sector.

From 6 April 2021, IR35 was expanded to include individuals who provide their personal services via a personal service company ('PSC') to medium or large private businesses. An intermediary may be another individual, a partnership, an unincorporated association or a company. The most common structure is a worker providing their services via their own company (PSC) which is the term used in this article to summarise the rules which will apply to all intermediaries.

On 23rd November 2021, Mitchell Charlesworth's Director of Tax Phil Hartley and DTM Legal's Senior Associate Elizabeth Judson delivered a seminar addressing some key issues that IR35 brings from both a tax and employment law perspective, which have been summarised in this paper.

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WHAT DOES EMPLOYMENT LAW HAVE TO DO WITH SELF-EMPLOYED CONSULTANTS?

Surprisingly, quite a lot, because the true employment status of a consultant isn't necessarily that of 'self-employed'.

WHAT IS THE EMPLOYMENT STATUS OF A CONSULTANT FROM AN EMPLOYMENT LAW PERSPECTIVE?

A consultant is a self-employed independent contractor who is engaged generally to provide specific expertise for a certain project. They can offer skill and expertise that you can't find within the employed workforce. It could be for a time limited project, or just because it works better in some way to engage individuals on a self-employed consultancy basis.

THE BENEFITS OF HIRING AN INDEPENDENT CONTRACTOR

Hiring a self-employed, independent contractor or consultant can be more commercial and flexible than an employment relationship; that's why its usage is common and it's useful where there is a limited or temporary requirement for the skills and expertise that the consultant provides.

THE PROBLEM

The use of consultants has come under increasing scrutiny in recent years, with many cases reported in the media of late from an employment law perspective, involving taxi and delivery drivers in particular, e.g. City Sprint[1], Deliveroo[2] and also the well reported case of Pimlico Plumbers[3].

Both the employment law and the tax status issues surrounding IR35 cause a problem for many businesses. Take for example the construction sector, which relies very heavily upon consultants. In some cases however, they might **not** be genuinely self-employed for employment law or tax purposes. So, many businesses have to either choose to move to an alternative way of working which just doesn't work for their business model (and can lead to claims in its own right by making that change), or take the risk of potential liability and fines.

In 2018 the Government published its policy paper, the **'Good Work Plan[4]'**, which recommended that the tests for employment law and HMRC/tax status should be brought in line with each other, at the time of publication it's unclear whether any of the proposed changes will be implemented, although the coronavirus pandemic may well have had an impact on their rollout.

STATUS DETERMINATION

So what can be done? One of the first steps an organisation should take when first engaging consultants is a **status determination** exercise. This will establish the status of a consultant for employment law and tax purposes, specifically having in mind what is taken into account when determining employment status for employment law purposes. The same can also be applied to existing consultants.

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1 https://assets.publishing.service.gov.uk/media/5f2a8dbe8fa8f57ac683d888/Mr_S_O_Eachtiarna_and_others_v_CitySprint__UK__Ltd_2301176-2018_and_others_Reserved_Judgment.pdf

2 https://www.bailii.org/ew/cases/EWCA/Civ/2021/952.html

3 https://www.bailii.org/uk/cases/UKSC/2018/29.html

4 https://www.gov.uk/government/publications/good-work-plan

USING CONSULTANCY ARRANGEMENTS

Needless to say, there are risks from an employment law perspective of engaging consultants who are not genuinely self-employed. There are two distinct types of consultancy arrangement; the 'classic' form, which is a self-employed arrangement between an individual consultant and the client of the business who requires the services, where the arrangement assumes that the consultant is genuinely self-employed, that is, they are in business on their own account and they are not an employee of the client.

This approach can have tax implications, particularly for the consultant, so it became increasingly common for clients to engage individuals via service companies (also known as a vehicle company or umbrella company) which can have advantages for the individuals working under the arrangements so they are attractive from a tax perspective, as they can limit liability for the individuals and they can also have tax advantages so payment can be made by way of dividends for example.

Previously, it was considered that if an individual was performing services under a service company then they were deemed to be genuinely self-employed. It's this use of service companies that has come under increasing scrutiny from HMRC, the employment tribunals, and the higher courts. Individuals can be found to not be genuinely self-employed under some circumstances irrespective of the existence of a service company. Previously, legal advice to **individuals** was to use a service company to demonstrate that they were genuinely self-employed, and to previously advise **businesses** to only

engage consultants by a service company. Employment tribunals and HM Revenue & Customs came to recognise this manouvre, hence their efforts to crack down on the avoidance of legislation and rights through that method.

"It is possible for an individual to have employment status for tax purposes but not for employment law purposes"

WHAT TESTS DO HMRC AND EMPLOYMENT TRIBUNALS USE?

The test to identify employment status for employment law and tax purposes, whilst similar, are not the same.

It is possible for an individual to have employment status for tax purposes but **not** for employment law purposes, because from a tax perspective there are only *two* categories; employed and self-employed, whereas from an employment law perspective there are *three* categories; employee, self-employed, and *worker*.

An important feature of the test is the actual substance of the relationship; the employment tribunal will look past the paperwork, instead focusing on the actual context of the relationship.

If the Employment Tribunal, irrespective of whether there's contractual documentation in place, (be it a self-employed agreement or a consultancy agreement) decide the contract is a sham, or not reflective of the actual circumstances of the relationship, they will effectively disregard its existence and instead will look at arrangements in practice.

The key thing to remember here, is that simply having a self-employed consultancy agreement in place is **not** sufficient to convince an employment tribunal that an individual is genuinely self-employed.

The Employment Tribunal will traditionally look to a number of different criteria when determining whether an individual is an employee or not. Some criteria overlap when testing from an employment and tax perspective, although the weight applied to each is different. Neither employment or tax status is determinitive of the other, but both HM Revenue & Customs and the employment tribunals will take into account the decision of the other when making a determination.

In employment law terms there are **three fundamental conditions** that must be met for an employment contract to be in existence and this is referred to as the *irreducible minimum*:

1. **Personal Service:** meaning that the individual must provide their own skill and work in return for pay

2. **Control:** there must be a sufficient degree of control over the individual by the client or the company, for example:

    - Whether they are subject to internal policies and procedures such as disciplinary and grievance procedures

    - Whether the individual is subject to restrictions on their outside activities, i.e. what work they can do alongside their engagement with the company

- Are they restricted from working as a competitor or with competitors for a period of time after the engagement has terminated?

- Whether they have an internal email address or an internal office within the business; and

- The length of notice period to terminate the engagement either way.

3. Other factors.

Only in extremely limited and exceptional circumstances would an employee not be required to provide personal services, it would be considered to be self-employed status if the contractor had the ability to substitute, i.e. be able to send somebody else to carry out the work in their place. this is key from the perspective of determining whether somebody is self-employed.

For example, if they were offered an alternative piece of work, they have the option to refuse to perform it themselves and send an alternative individual/contractor. If that is acceptable to the hirer, then that individual is likely to genuinely be self-employed.

This right of substitution must be unfettered, that is to say, it isn't controlled by any one person, or any one thing.

For example, in ***Pimlico Plumbers v Smith [2018] UKSC 29***, an individual engaged as a consultant for Pimlico Plumbers claimed to be an employee, an assertion denied by Pimlico Plumbers who claimed a right of substitution existed. In fact, Pimlico Plumbers had to approve the substitution, meaning that this was not unfettered, and the plumbers were in fact *workers,* not genuinely self-employed.

This finding applied in further cases, including *Stuart Delivery Ltd v Augustine [2021] EWCA Civ 1514*[5], which again involved moped drivers. In this case, they found that the right of substitution was not unfettered because of the fact they could *only* send another Stuart Delivery driver along in their place, and not just 'anybody'.

WHAT CONSTITUTES AN UNFETTERED RIGHT OF SUBSTITUTION?

Take for an example an individual, who operates as a limited company, owning a number of vans with a number of drivers working for him. He has a contract with a large UK based parcel delivery brand. He doesn't conduct any deliveries himself, instead, he instructs one of his drivers i.e. his employee, to deliver in his place. The parcel delivery brand cannot influence or control who the limited company sends to conduct deliveries, so this hire is *unfettered*.

MUTUALITY OF OBLIGATION

This is the obligation on a company to provide work, and the individual to accept work. In considering the obligation, what would be the employment status if either of those things didn't happen?

5 https://www.bailii.org/uk/cases/UKEAT/2019/18_0219_0512.html

For example, an organisation has an engagement with a consultant, and that consultant was offered some work which they subsequently declined, what would be the implications of that? Would the engagement be terminated by the hirer company, or is the individual a genuine self-employed contractor who can therefore refuse to accept the work? If declining the work is acceptable to the hirer, then there is no mutuality of obligation.
Is there an obligation for the hirer company to give the individual work? How does the individual react if the company doesn't give them work? If the company provides a piece of work after a long period of time, is that absolutely fine with the individual? If yes, there is no mutuality of obligation.

There are many other factors that will be taken into consideration as part of the test. For example:

- Who takes the financial risk?
- Does the individual profit from performance and if so, what does that look like?
- Are they paid a fixed wage or salary?
- Are they paid when they are absent?
- Do they receive paid holiday or paid sick pay?
- To what extent are they integrated in the business?
- What do they do when they are not carrying out work, for

example, are they carrying out work for lots of other different companies?

- Is the sub-contractor provided with tools and equipment, or are they expected to provide their own?

Clearly, there are many factors that will be taken into account, but in reality, the main deciding factor that HMRC and the Employment Tribunal will apply to determine self-employment, is whether the sub-contractor has an *unfettered right to substitute*. Other factors are merely helpful in arriving at that conclusion.

WHAT IS A "WORKER" AS DEFINED IN EMPLOYMENT LAW?

There is a middle ground between 'self-employed' and 'employee' which is that of "worker". The definition is quite wide. Essentially, workers have *some* rights that employees have, but not *all* of them.

For example:

- The right not to suffer unlawful deduction from wages
- The right not to suffer a detriment if they whistleblow
- Applicable rights under the Working Time Regulations, such as holiday entitlement, rest breaks and other core employment rights
- The right to receive the National Minimum Wage
- Protection from discrimination
- To receive a written statement of particulars.

The latter point is relatively new; it should be remembered that it is not a written statement of employment particulars, instead, it is more a contract for the personal performance of work.

WHAT ARE THE IMPLICATIONS FROM AN EMPLOYMENT LAW PERSPECTIVE WHEN ENGAGING A SELF-EMPLOYED INDIVIDUAL, WHO SUBSEQUENTLY CLAIMS TO BE AN EMPLOYEE?

- Backdated holiday pay

If an employment tribunal finds a self-employed individual to actually be an employee, potential liabilities for the employer include backdated holiday pay for the period of the hire. There are some circumstances that can 'break' the claim, so that the holiday entitlement can be shortened to a lesser period of time, but at the time of writing, this is subject to proceedings in the higher court.

- The right to not be unfairly dismissed

If the relationship turns sour, and a self-employed individual is successful in claiming they have been unfairly dismissed, then they will be entitled to receive a basic award of compensation which is the equivalent of a redundancy payment, plus a compensatory award which is up to 12 months' net loss of earnings.

- Protection under TUPE

Where the undertaking of the business transfers to another company for example, their employment is protected as are their terms and conditions. In some cases, workers can be protected under TUPE as well.

- The right to family friendly pay
- The right to request flexible working.

AS THE HIRER, HOW CAN WE MINIMISE OUR RISK SHOULD THIS HAPPEN?

Previously, for a long time, the biggest protection that a business could have when engaging consultants was an indemnity in the self-employed or consultancy agreement. The intention of the indemnity clause is to specify that the nature of the engagement is genuinely that of self-employment, and if the self-employed individual thereafter claims that they are in fact an employee or a worker, then they indemnify the company for any compensation awarded and any costs suffered by the company.

Such a clause must be treated with a degree of caution since the case of *Uber BV v Aslam [2021] UKSC 5*[6], whereby the court in its findings clarified that since worker status is created by legislation containing restrictions on contracting out, any contractual provision which purports to classify the party's relationship or limit the worker protections are void and must be disregarded.

This leaves employers/hirers unable to rely on this indemnity, where a self-employed individual is claiming that they are an employee or worker – hirers are now unable to recover any compensation or costs from that individual when faced with a court decision finding the self-employed is actually an employee.

POINTS TO REMEMBER

- From an *HMRC* perspective, somebody can either be employed, a worker, or self-employed
- From an *employment law* perspective, somebody can either be employed or self-employed. If there is no unfettered right to substitute then it's not possible for an individual to be genuinely self-employed – this is key to determining self-employment status from an *employment law* perspective
- When determining status, companies need to consider the three factors above, you need to consider personal service, control, and the other factors mentioned such as mutuality of obligation, and the right to substitute.

IN HMRC'S VIEW, WHO DECIDES THE EMPLOYMENT STATUS – THE HIRER OR THE CONCTRACTOR?

From April 2021, businesses with an annual turnover exceeding £10.2 million became responsible for determining the employment status of the contractors it is using.

WHAT ARE THE THREE TESTS THAT DETERMINE EMPLOYMENT STATUS FROM HMRC'S PERSPECTIVE?

Similar to employment law, the three key areas are:

- Mutuality of Obligation
- Control; and
- Right of Substitution.

[6] *https://www.bailii.org/uk/cases/UKSC/2021/5.html*

These are the three areas that are commonly being pressed home by the Judges in the case law we have cited in this paper.

HOW DO HMRC INTERPRET MUTUALITY OF OBLIGATION?

From an engager's perspective, this is an obligation to provide work to the contractor and an obligation on the contractor to accept and perform the work. HMRC treat this as the most significant test that they have within the legislation. They take a very strong stance on Mutuality of Obligation to the extent that they consider that Mutuality of Obligation is prevalent in every contract that is entered into.

HOW DO HMRC INTERPRET 'CONTROL' IN THE CONTEXT OF EMPLOYMENT STATUS RULES?

If the engager does not have any input over how, when and where the work is undertaken, and instead, that right sits with the workers and contractor, then there is no 'control'. For example, the high-profile case brought by Eamon Holmes[7] failed after the tax tribunal found that the appellant (Holmes) did not have 'control' over the content of the television shows he was presenting. In contrast, TV presenter Kaye Adams[8] won her case at the tax tribunal, as she could demonstrate that she had significant control over what could be included on her programme 'Countryfile'.

BUT...

In a further celebrity case, this time involving Lorraine Kelly[9], the tribunal stated that Kelly "*carried out her work with autonomy and ITV Breakfast Limited did not have direct control over the way she provided her services*", this finding was a key factor in the determination of future cases; she **did** have that control; she had the autonomy to decide how she presented the show, what was included and what wasn't included.

Confusingly, this is despite the fact that the rights of substitution were not unfettered, as whilst she had the choice to suggest certain individuals as her temporary replacements from time to time, ultimately, the decision on choosing a substitute was ITV's . In reality, it's unlikely that ITV would object to any of Lorraine's suggestions, but the fact remains that the substitution right was not unfettered, yet she still won the case. Another example where the tribunal works on a case by case basis, reviewing all of the facts of the case.

HMRC'S CEST TOOL

HMRC, in their efforts to help contractors, businesses and agencies developed the 'CEST' Tool[10] (**C**heck **E**mployment **S**tatus for **T**ax). which is a series of specific, pre-set questions , the answers to which will determine employment status. The resulting determination can be used as evidence to support hirers, agencies or the workers' position if a certain individual is deemed to be within IR35 legislation or otherwise.

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7 *https://www.bailii.org/uk/cases/UKFTT/TC/2020/TC07603.html*

8 *https://assets.publishing.service.gov.uk/media/602fa8f6d3bf7f721b700f18/HMRC_v_Atholl_House_.pdf*

9 *https://financeandtax.decisions.tribunals.gov.uk/judgmentfiles/j11009/TC07045.pdf*

10 *https://www.gov.uk/guidance/check-employment-status-for-tax*

The tool does not come without its critics. As we know, one of the biggest tests within IR35 is Mutuality of Obligation, which HMRC automatically consider to be within *any* engagement and contract, so it can be argued that CEST is somewhat biased. Indeed, it gave a contrasting result when the circumstances of Lorraine Kelly's case were input – the CEST result directly conflicted with the finding of the First Tier tribunal! Clearly then, the outcome of CEST cannot be completely relied upon.

Whatever the outcome, we would recommend retaining the results from the CEST tool in case they are needed in the future.

IN WHAT CIRCUMSTANCES DOES A SUB-CONTRACTOR MAKE THEIR OWN STATUS DETERMINATION?

From April 2021, the rules changed so that medium and large private sector entities now have the responsibility to determine the employment status of the worker, rather than the sub-contractor/worker. However, for entities with turnover *below* the turnover threshold of £10.2m, the responsibility remains with the sub-contractor. Clearly though, as it is more beneficial for them to be considered a genuine sub-contractor/worker rather than an employee, they would probably not examine their position in any great detail.

WHAT WOULD BE THE IMPLICATION FOR THE SUB-CONTRACTOR OR WORKER IF FOUND TO BE WITHIN IR35?

If determined to be within the IR35 rules, the earnings from the contract will then be subject to deductions of Income Tax and National Insurance by the engager before being paid over to the PSC/sub-contractor/worker. However, due to the differences between the employment law perspective and the tax law perspective, it doesn't necessarily follow that the worker has *all* the rights associated with being employed, so the worker can continue to work within the PSC structure but will be taxed as if they were an employee.

This means that the earnings of the PSC, won't be subject to Corporation Tax, as it will already have been taxed through payroll, however VAT is still applicable. If the PSC is registered for VAT, then VAT will still need to be charged and paid over to HMRC by the PSC accordingly. This puts the PSC in a quandry; if on one hand HMRC determine them to be within IR35 then why shouldn't they be on the hirers' payroll and enjoy the benefits of employee status? Hirers are under no obligation to do this however.

HOW SUCCESSFUL HAVE HMRC BEEN IN SINCE IMPLEMENTING THE CHANGES?

There have been a mixed bag of results so far, but we wouldn't expect that to deter HMRC from continuing to review employment status classifications, as clearly this is potentially a strong revenue stream for the Government.

REMEMBER...

It's important for hirers to consider the position from the **outset** of the engagement, rather than retrospectively. We would also recommend that the contract states exactly how the relationship between hirer and contractor will work in practice, that it's defined clearly from the outset, and accurately reflects how the relationship operates..

SOME CASE STUDIES...

HOW DOES IR35 AFFECT SITUATIONS WHEN HIRING A LOCUM?

Example: The hirer hires a locum from an employment agency on an ad hoc basis. They are found through the agency, they are paid through the agency, but they can perform the work wherever they want, whenever they want.

From an employment law perspective, the Employment Tribunal may assess that situation and determine that whilst it's a short term project, in reality, what does it look like during the hire period? Even in a situation where somebody is genuinely self employed, they may occasionally undertake some work for one company, and some work for another company i.e. they could be an employee for a short term period, or they could be employed under an umbrella contract where they attend the hirer's place of work for weeks at a time sporadically, or there may be a global contract of employment, or as a casual worker during that period of time. It all depends on the actual details of the engagement period, once again, from an employment law perspective, it boils down to whether there is an unfettered right to substitute.

If it is a very specific or niche hire, i.e. a locum solicitor, the PSC would not be able to send somebody else along in their place without either the agency or engager's approval. For example, a conveyancer locum would not be able to suddenly send a substitute, as that substitute would not have been approved by either the agency or the engager. In such circumstance it's highly likely they wouldn't be self employed because, the right to substitution does not exist – it is fettered.

From a tax perspective, the pain point sits with the agency; they are the entity that is engaging with the worker, so for the engager, the responsibility sits with the agency to determine whether they should be paying the PSC, and if they have to make that determination, should they be paid via payroll instead?

WOULD THIS MEAN THAT IR35 BECOMES THE PROBLEM OF THE EMPLOYMENT AGENCY, RATHER THAN THE ENGAGER?

To a certain extent, yes. They are the entity that has to decide how to treat the payment of the individual from an IR35 perspective, however this will also have ramifications from an employment law perspective, because dependent on who is making the payment, will influence the finding of an Employment Tribunal who could find that there is actually engagement between the end user and the agency.

I AM SELLING MY COMPANY BUT HAVE BEEN ASKED TO PROVIDE CONSULTANCY SERVICES TO THE NEW OWNERS FOR A FIXED PERIOD OF TIME. WILL I BE CONSIDERED A CONTRACTOR, OR AN EMPLOYEE?

Ultimately, this will boil down to whether the individual has control over what can and cannot be done in the business; the substance of the engagement will determine this status, as well as the contract.

Also, the size of the purchasing company who will be the engager will also be crucial in determining status, given that IR35 only applies to companies *above* the audit threshold.

Points to consider in this situation:

1. What does the contract say?
2. What is the size of the engager?
3. How does the relationship work in practice, irrespective of the contract terms?
4. Is there a set amount of hours per week for a set amount of time as determined by the engager, or does the contractor pick and choose their own days, hours, holiday times etc?

In such circumstances it is vital that you take the advice of an employment law advisor to ensure your employee rights are protected.

With thanks to our speakers, Elizabeth and Phil. Should you have any questions then you shouldn't hesitate to contact them.

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