

# His Dark Materials

Employment Tax

Personal tax



29 July 2021

Keith Gordon reviews the Upper Tribunal's decision in the case of Northern Light Solutions, examining the rules relating to IR35

## Key Points

### What is the issue?

After an apparent lull in IR35 challenges, there has been increased focus by HMRC in more recent years. The case of Northern Light Solutions Ltd v HMRC [2021] UKUT 134 (TCC), relating to a contractor, shows that HMRC has renewed the pressure on this sector of the workforce.

## **What does it mean for me?**

The case focused on the first two stages of the Ready Mixed test: mutuality of obligations; and the requirement for personal service. HMRC will no doubt point to this case as a major vindication of its oft-stated position that many contractors' contracts ought to be 'inside IR35'.

## **What can I take away?**

Advisers should recognise that HMRC's victory in this case is not a significant development in the sphere of employment status disputes. However, there is a risk that the decision will be used by HMRC to downgrade the highly significant substitution test in favour of a dominant feature test.

The so-called 'IR35' legislation is now 21 years old. However, a rush of recent cases and a new set of procedures which came into force in April mean that the rules are more topical now than ever.

As is well known, the rules target arrangements whereby an intermediary is interposed into what is essentially an employment relationship, so that the 'employer' contracts with the intermediary which onward supplies the services of the would-be employee. The legislation was introduced to prevent abusive avoidance of the PAYE and NIC code and it is probably fair to say that the abusive arrangements ceased upon enactment of the rules in 2000 (or those which persisted were not defended once HMRC started to challenge them). Consequently, the litigated cases in this area have concerned workers whose employment status is less clear cut, with contractors being particularly prone to an HMRC challenge, particularly in the first decade of this century.

After an apparent lull in IR35 challenges, there has been increased focus by HMRC in more recent years. Indeed, in the past couple of years alone, four cases have now been heard by the Upper Tribunal, three of which involved television and radio presenters. The fourth case, Northern Light Solutions Ltd v HMRC [2021] UKUT 134 (TCC), however, relates to a contractor, showing that HMRC has renewed the pressure on the one sector of the workforce which has long borne the brunt of HMRC's policing of these rules.

## **The facts of the case**

The case concerns a Mr Lee, who operated as a project manager through his personal service company, Northern Light Solutions Ltd. In the period in question, he was working on a succession of contracts for businesses in the financial services sector (Nationwide Building Society and Lloyds Bank). The contracts varied in length from a few weeks to a few months. HMRC's IR35 challenge related solely to the work carried out for Nationwide.

Typically, Mr Lee's role would be to oversee the implementation of projects being introduced by Nationwide, heading project teams and liaising with senior management. Under the contracts, Mr Lee would be required to work for seven and a half hours per day on a five-day week basis, although he often worked for more hours, for which he (or, more strictly, the company) was not remunerated. Although officially based at Nationwide's head office in Swindon, Mr Lee often worked closer to his home in the north west on Mondays and Fridays. The company would be remunerated at a daily rate.

Given that this was an IR35 case (rather than a straightforward employment status dispute), the First-tier Tribunal was obliged first to ascertain the terms of a hypothetical contract between Mr Lee and Nationwide, taking into account the actual contractual arrangements in place. By reference to this hypothetical contract, the tribunal was then required to apply the generally accepted three-stage test for employment status, as first set out by Mr Justice MacKenna in *Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance* [1968] 2 QB 49. Applying this test, the tribunal concluded that the hypothetical contract did indeed constitute one of employment.

The company appealed against the First-tier Tribunal's decision to the Upper Tribunal.

## **The Upper Tribunal's decision**

The case came before Upper Tribunal Judges Timothy Herrington and Guy Brannan. The case focused on the first two stages of the *Ready Mixed Concrete* test. As for mutuality of obligations, the precise meaning of this test has long been disputed and this debate arose in the present case. In particular, does it mean any more than that there exists a contract for work under which payment will be due to the worker? Northern Light sought to argue that there was insufficient mutuality of

obligations because, at the end of any one project, there was no obligation on either Nationwide or Northern Light to enter into a further contract for a new project.

The Upper Tribunal considered that this did not mean that, during the subsistence of any contract, there was no mutuality of obligations.

The Upper Tribunal also considered the company's further argument on mutuality of obligation, being that the work being provided was task-specific and that Nationwide could not direct Mr Lee to carry out a different task. However, the Upper Tribunal considered that this point was more pertinent to the question of control (the subject of stage two of the Ready Mixed Concrete test).

In relation to the requirement for personal service, the First-tier Tribunal had recognised that a contractual right to appoint a substitute need not be exercised in order to be effective. However, in the contracts under review, that right of substitution was subject to Nationwide's reasonable right of refusal. The First-tier Tribunal had concluded that Mr Lee's skills and knowledge (being the reason for his being engaged in the first place) 'meant that it was difficult for Mr Lee to offer a substitute that Nationwide acting reasonably would accept'.

Northern Light sought to argue that, in the absence of any witness evidence from Nationwide, these conclusions were speculative and therefore there was insufficient evidence to justify the tribunal's findings of fact. However, the Upper Tribunal referred to the meeting notes and the undisputed length of Mr Lee's relationship with Nationwide to say that there was sufficient factual evidence on which the First-tier Tribunal was entitled to base its conclusion. The Upper Tribunal chose not to embellish its decision on that point; for example, by commenting on whether or not it might have reached a similar conclusion on the same evidence. This was probably a wise move: the point is that the First-tier Tribunal is entitled to reach factual conclusions on the basis of the evidence before it and, absent any error of law, the Upper Tribunal is bound by the First-tier Tribunal's decision.

Finally, the Upper Tribunal rejected Northern Light's arguments on control and confirmed that the First-tier Tribunal was entitled to reach the view that there was sufficient control over Mr Lee (the task to be performed, where he was to work and the working hours) to satisfy the control test. Mr Lee was a skilled worker, likened to master mariners and surgeons, whose 'employer' would in practice have little control as to how the tasks would be performed but who would nevertheless

exercise sufficient control over the worker to be the worker's 'master'.

## **Commentary**

HMRC will no doubt point to this case as a major vindication of its oft-stated position that many contractors' contracts ought to be 'inside IR35'. However, it is my clear view that, besides endorsing earlier tribunals' decisions on mutuality of obligations (for which see below), the case sheds no light on the more obscure areas of employment status, the point which lies at the heart of all IR35 disputes to date. This can be illustrated by considering in further detail the three Ready Mixed Concrete stages.

In many cases involving contractors (and also those in the television and radio industry), personal service is pretty much a given. Indeed, when I represented the taxpayers in the cases of Albatel (Lorraine Kelly) and Atholl House (Kaye Adams), I wasted no time suggesting that the personal service condition was not met. I accept that, unlike many in the broadcasting world, a lot of contracting agreements contain a qualified right of substitution. However, as this case demonstrates, even to the extent that such rights are genuine, such terms will not always be sufficient to take a relationship outside the scope of an employment. Of course, that will have to be considered on a case by case basis.

Furthermore, I must nevertheless express concern about one aspect of the Upper Tribunal's decision on personal service. The Upper Tribunal made reference to the Supreme Court's decision in *Pimlico Plumbers Ltd v Smith* [2018] UKSC 29 and suggested that the correct way to approach the effect of any right of substitution is to consider 'whether the dominant feature of the contract remained personal performance on [the worker's] part'. In the present case, Mr Lee's specialist skills and knowledge meant that, in the Upper Tribunal's view, the dominant feature of the hypothetical contracts, in this regard, was an obligation for personal performance. In my respectful view, however, the Upper Tribunal went one stage too far and risked putting the proverbial cart before the horse. If one considers how the test was applied in *Pimlico Plumbers*, it is clear that the dominant feature of the contract there was determined by the long list of personal obligations on Mr Smith when interacting with clients – indeed, the contract contained a long list of obligations prefaced by the words 'you' and 'your'. Furthermore, when then proceeding to consider the effect of the substitution clause, the Supreme Court noted that the pool of potential substitutes was limited to other operatives who were already bound by

Pimlico Plumbers' heavy obligations.

In Northern Light, the Upper Tribunal has effectively suggested that the question of substitution has itself been substituted by a dominant feature test. But, as the Supreme Court itself warned: 'The sole test is, of course, the obligation of personal performance; any other so-called sole test would be an inappropriate usurpation of the sole test.'

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Control, similarly, must be considered on a case by case basis. However, in relationships where the client (i.e. the putative employer) has the right to call on the worker's services, the test will often be satisfied. In many ways (and this is inevitably a short cut which should be treated with some caution), the point can boil down to whether, on a particular 'working day', the worker can choose which client to work for (or whether simply to take the day off). For most contractors engaged in what might be loosely described as 'nine to five' contracts, they are likely to be subject to sufficient control so as to satisfy the second stage of the Ready Mixed Concrete test, whereas those with a portfolio of clients whose cases are worked on at the worker's own discretion should find that their relationships fall outside the definition of employment.

Again, the Atholl House case provides a useful contrast. In the First-tier Tribunal, the tribunal had reached the view that the true contractual relationship between Ms Adams, her company and the BBC meant that 'far from being entitled to compel her to refuse her other engagements on the basis both that it had first call on her time and that Ms Adams required its permission to enter into those other engagements, the BBC did whatever it could to accommodate those other engagements'. This led to the tribunal concluding that 'the BBC had no control over Ms Adams' ability to enter into those other engagements'.

Although the final decision on the control test is not totally clear, it is generally understood that the First-tier Tribunal took the view that there was insufficient control in that case. However, the Upper Tribunal considered that the First-tier Tribunal had wrongly determined the terms of the actual contractual relationship and that, in fact,

‘the BBC could compel Ms Adams to present the Kaye Adams Show and undertake reasonable tasks associated with that role’. This revised analysis of the facts led the Upper Tribunal, when remaking the decision, to conclude that ‘overall ... there was a sufficient framework of control for the second Ready Mixed Concrete test to be satisfied’.

In Atholl House, therefore, the case turned on the final stage of Ready Mixed Concrete, which effectively allows a common sense view of the relationship to prevail, so that what is clearly a self-employment relationship is not to be classified as one of employment merely because the first two stages of the test are overcome. In Atholl House, the taxpayer prevailed, although that decision is now the subject of HMRC’s further appeal to the Court of Appeal.

It would have been illuminating therefore to see what the Upper Tribunal had to say about that third stage in the present case.

Regrettably, however, the taxpayer was understood not to have raised such arguments when seeking permission to appeal. Although the arguments were aired in the taxpayer’s skeleton argument, the Upper Tribunal considered that this was too late in the day and declined to admit this additional ground. As a result, we are still in the dark as to how the third stage of the Ready Mixed Concrete test might be applied in this latest raft of IR35 challenges.

Finally, the comments made by the tribunal on mutuality of obligations might disappoint those who maintain that the very precariousness of a contractor’s work negates the existence of any mutuality of obligations. However, for the reasons I set out at more length a year ago in my article ‘MOOnopoly’ in Taxation (9 July 2020), I consider that this precariousness is more relevant to the third stage of the Ready Mixed Concrete test, something which (regrettably) the Upper Tribunal did not consider on this occasion.

## **What to do next**

Advisers should therefore recognise that HMRC’s victory in this case is not a significant development in the sphere of employment status disputes, as most battles concern the third stage of Ready Mixed Concrete, which did not feature in the present case. However, there is a risk that the Upper Tribunal’s decision will be used by HMRC to downgrade the highly significant substitution test in favour of a dominant feature test. For the reasons set out above, this risks misinterpreting what

the Supreme Court said in Pimlico Plumbers and advisers should be careful in this regard.