# The IR35 lottery

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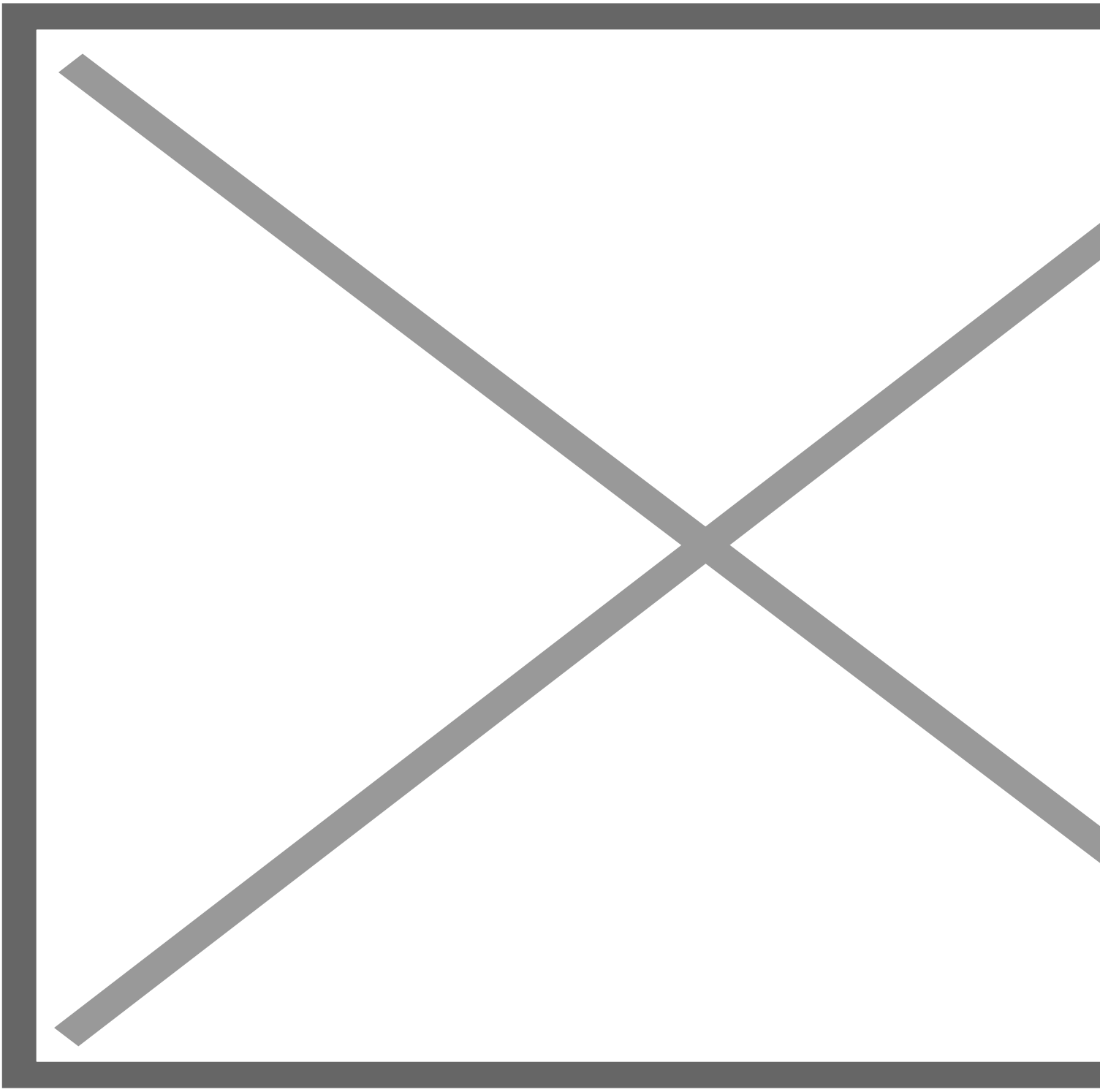

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*Peter Rayney* notes the rough justice meted out to *Christa Ackroyd* in the recent IR 35 case and considers whether there is even more trouble on the horizon

On 20 March 2018, just a few weeks after the First-tier Tribunal had released its decision in the *Christa Ackroyd* case, four BBC broadcasters assembled before a House of Commons' Select Committee to provide evidence about their BBC pay structure. A number of BBC presenters and broadcasters revealed that they been 'invited' or encouraged by the Corporation to provide their services through personal service companies ('PSCs').

It has been widely reported in the press that HMRC launched a crackdown on the operation of the so-called IR 35 rules to PSCs. Probably as a result of this, the Select Committee heard that many presenters and broadcasters were now facing 'six-figure' tax and National Insurance Contributions (NICs) demands for failing to apply IR 35 to their historic 'BBC' income.

## The IR 35 rules

The IR 35 (named after the Budget Press release outlining the proposals) provisions are to be found in Chapter 8, Part 2, Income Tax (Earnings And Pensions) Act ('ITEPA') 2003. This legislation was introduced in 2000 by the then chancellor Gordon Brown to tackle the emerging problem of 'disguised employment'. HMRC had justified these 'new' rules on the grounds that it was feasible for someone to leave their employment on Friday and return as a PSC contractor the following Monday with the benefit of a significantly reduced tax bill (albeit with the loss of entitlement to some benefits)! Although IR 35 was introduced some 18 years ago, it is probably more relevant than ever, due to the growth in the 'gig' economy. The fact remains that the tax and NIC costs for 'employment' still remain higher than those relating to self-employment.

As the IR 35 provisions then stood (they were fundamentally altered on 6 April 2017 for public sector-based work – see below), the owner-worker of a PSC was obliged to determine whether its fee income should be treated as generated from an employment or 'self-employment' relationship with the client/end-user. The legislation achieves this by imputing a hypothetical contract between the worker and the client/end-user.

It then poses the question whether this deemed contract gives rise to an employee relationship. Where this is the case, the IR 35 legislation applies and the income arising from that deemed 'employment' contract (after making certain allowable deductions) is treated as deemed earnings paid by the PSC. Since 2013, the same rules apply where the worker is an office-holder (director) of the end client.

Where IR 35 applies, the PSC is responsible for applying PAYE and NICs (including employers' NIC at 13.8%) on the deemed salary. See illustrative example below, which shows how the 'deemed salary' payment for a typical PSC might be calculated.

**Example – IR 35 deemed salary calculation**

Mr Gareth was a specialist IT consultant to two firms in the media industry (both based in the private sector). He worked through his personal service company – Gareth's Three Lions Ltd ('GTLL').

A summary of GTLL's income and expenses for the year ended 31 March 2018 showed the following:

| | | |
|---|---|---|
| | **£** | **£** |

| | | |
|---|---|---|
| IT consulting fees | | 150,000 |
| Less: Operating expenses | | |
| Salary (Mr Gareth) | 36,000 | |
| Employers' NICs (re Mr Gareth's salary) | 3,842 | |
| Travelling expenses | 4,370 | |
| Accountacy | 2,250 | |
| Allowable use of home as office | 1,200 | |
| Professional Indemnity Insurance | 1,250 | |
| Sundry office expenses | 7,288 | 56,200 |
| Net Profit | | 93,800 |

Mr Gareth accepts that all his IT consulting fees would represent employment income if he had worked directly for the two media firms. Consequently, his deemed salary for IR 35 purposes in the year ended 31 March 2018 would be calculated as follows:

| | £ | £ |
|---|---|---|
| IT consulting fees | | 150,000 |
| Less: Allowable expenses under s54 ITEPA 2003* | | |
| Allowable use of home as office (s316, ITEPA 2003) | 1,200 | |
| Professional indemnity insurance (s316, ITEPA 2003) | 1,250 | |
| Salary (Mr Gareth) | 36,000 | |
| Employers' NICs (re Mr Gareth's salary) | 3,842 | |
| General expense allowance<br>5% x (fees) £150,000 = | 7,500 | 48,792 |
| Deemed IR35 salary and employers' NIC | | 100,208 |

*Unfortunately, due to the restrictions introduced on 6 April 2016, the ‘home to work’ travelling costs cannot be deducted in the ‘deemed salary’ calculation since Mr Gareth is under the direct supervision of the two media firms.

GTLL would be required to apply PAYE and employee NICs on a deemed salary of £88,056 (£100,208 x (100%/113.8%) and account for employer’s NICs of £12,152 (£88,056 x 13.8%).

## HMRC’s IR 35 crackdown

While it is possible to see how the 'Friday to Monday' fiscal makeover could arise with IT contractors, taxi drivers, engineers, and the like, it is less easy to see how the rules might apply to those providing 'unique' services like leading TV and radio presenters, well-known actors, musicians, and so on. This takes us to the heart of the *Christa Ackroyd* case, which involved a well-known BBC presenter.

There have been many reports of HMRC investigating the tax status of BBC/other TV and radio presenters. Since a large number of these presenters are known to be working through PSCs, it is very likely that HMRC has been seeking to determine whether these PSCs have been correctly applying the IR 35 legislation. We know from the recent select committee hearing mentioned above that a large number of the BBC's presenters had been encouraged to work though PSCs. It will be appreciated that, under the pre-6 April 2017 IR 35 regime, a 'public sector' engager (or end-user) would not have to pay significant employer's NICs nor provide any employment rights or benefits.

One of the fundamental criticisms of IR 35 is that it is often not easy to determine whether a particular contract represents one of employment or self-employment. There is a long line of employment and tax-related jurisprudence that demonstrates the complexities that are involved, and many decisions have shown inconsistencies in approach. Yet the obligation to determine the 'employment' or 'self-employment' status rested with the PSC owner (or perhaps more often than not, their accountant or tax adviser!). For a brief period, HMRC introduced business entity tests with the aim of providing a risk-based approach to the IR 35 status analysis. Broadly, this was founded on a 'points' rating with different weighting for various 'indicators' of employment. But these tests were strongly criticised and HMRC withdrew them in April 2015

There is also strong anecdotal evidence that HMRC has not previously 'policed' the operation of IR 35 very well. This has probably given the PSC owners and their advisers a false sense of security that they had no historical IR 35 tax exposure.

## The *Christa Ackroyd* case

In the light of the above background, it is perhaps not surprising that the First-tier tribunal's ruling in *Christa Ackroyd Media Limited v HMRC* [2018] TC06334 attracted widespread media interest. This was the first major test case that looked at the typical freelance contracts that are used in the broadcasting industry.

Briefly, Ms Ackroyd had been a presenter on BBC's successful 'Look North' programme for more than a decade. However, she supplied her services through her PSC – Christa Ackroyd Media Ltd ('CAM'). She worked under two-fixed term contracts between CAM and the BBC. HMRC claimed that CAM should have accounted for PAYE and NICs under IR 35 over the tax years 2006/07 and 2012/13. The total amount due to HMRC was in excess of £400,000.

The following findings of fact were made:

- The BBC had the ultimate right to specify the specific services that Ms Ackroyd would provide (although she might ad lib in a 'live news environment). She was subject to the BBC's editorial guidelines (which ran to over 350 pages specifying the standards and practices that had to be applied). The tribunal appeared not be convinced by Ms Ackroyd's arguments – for example it rejected her claim that she could make any changes to the *Look North* format she wanted. The BBC clearly controlled the editorial content of the programmes.
- Ms Ackroyd could not provide services to any other organisation without the BBC's consent.
- The BBC required Ms Ackroyd to work at least 225 days each year for which it would pay the relevant 'monthly' contracted fees. She could also be called upon by the Corporation to provide other broadcasting

services and attend ‘public events’.
- CAM could *not* use a substitute for Ms Ackroyd.

The tribunal noted there were some inconsistences between the oral evidence given by Ms Ackroyd with the details that had previously been provided in correspondence!

Considerable reliance was placed on the leading case of *Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance* (1968) 2 QB 497. Based on the above findings of fact, the tribunal found that two key characteristics of employment – mutuality of obligation and ‘control to a sufficient degree’ – were both present in this case. The fact that Ms Ackroyd benefited from a ‘seven-year’ contract – this was a ‘highly stable, regular and continuous arrangement’ – pointed towards employment. Furthermore, it was noted that the absence of a right to provide a substitute might also indicate employment status.

The key question the tribunal had to consider was summarised as follows:

“If the services provided by Ms Ackroyd were provided under a contract directly between the BBC and Ms Ackroyd, would Ms Ackroyd be regarded for income tax purposes as an employee of the BBC?”

In reaching its conclusion, the tribunal made an ‘overall qualitative assessment of the circumstances’, and found that Ms Ackroyd was an employee for income tax purposes. This meant that her company, CAM, would be liable for PAYE and NICs (based on the deemed IR 35 earnings calculations).

## Further thoughts

The longevity of Ms Ackroyd’s arrangements with the BBC was probably an unhelpful factor since the longer the engagement the more likely it is that the ‘worker’ is seen as ‘part and parcel’ of the engager’s business. This principle was also demonstrated in the *Fall v Hitchen* [1973] STC 66 case, which concluded that a ballet dancer was engaged by Sadlers Wells under a contract of employment. This contract provided for full-time work and restricted him from performing for anyone else.

The tribunal’s conclusions in the *Christa Ackroyd* case remind us of the subjective nature of the ‘employment v self-employment’ analysis. It is arguable the analysis for a TV or radio broadcaster should place greater weight on their often unique talents and personality. Understandably the BBC would supervise and control the editorial content of *Look North* – after all it is its programme! The BBC clearly used Ms Ackroyd for her ‘personal’ broadcasting talents and ability to attract viewers. That explains why she was not permitted to appoint a substitute.

Furthermore, in my experience, when a business engages someone with special skills and talent, it will still normally set the terms of reference and often indicate (at least to some extent) how those services should be performed. This should not necessarily make them an employee.

One of the leading cases in this area is *Hall v Lorimer* [1994] STC 23 (CA). In this case, the Court of Appeal found that a ‘freelance’ TV vision mixer who worked for some twenty different companies on short-term contracts was self-employed. The court stressed that it was necessary to look at all the aspects of a worker’s activities to assess whether they were in business on their own account (i.e. self employed). Some of the relevant factors would include:

- the provision of similar services to many engagers (which may be of a short term nature);
- the worker provides professional services or those requiring rare skills and judgement;
- the worker has a business-like approach to obtaining and organising their engagements;

- the worker is exposed to financial risk and also the possibility of not being paid (i.e. bad debts); and
- the parties do not intend to create an employment.

The *Christa Ackroyd* case represents the first of a number of appeals relating to the application of the IR 35 legislation to television presenters but the tribunal emphasised that it should not be regarded as a lead case. This underlines the fact that these 'IR 35' cases will always be decided on the tribunal's view of the facts and a slightly different fact pattern and/or a special factor may lead to a different conclusion.

We have seen that the assessment of whether someone is employed or self-employed' is fraught with difficulties. This seems to be especially so in the TV and Film Production industry, as demonstrated by HMRC Guidelines for this sector. Appendix 1 of these guidance notes helpfully contains many types of worker that HMRC normally accepts as self-employed.

## Off-payroll working

Since 6 April 2017, there has been a further twist in the operation of IR 35 for PSCs working for the vast majority of public sector bodies (which includes the NHS, local authorities, as well as the BBC and Channel 4). The radical change is that the responsibility for paying the PAYE and NICs shifts to the engager (i.e. the party paying the PSC).

This means that the public sector engager now has to decide whether the worker should be treated as an employee at the time of payment. To assist in this process, HMRC has introduced an online employment status tool (often referred to as CEST). However, while the findings produced by a CEST may be helpful, they should not necessarily be taken as conclusive. For example, it fails to take 'mutuality of obligations' into account when determining status.

Both reported and anecdotal evidence suggests that a large number of public sector organisations are taking a 'risk averse' approach. It is also been reported that around 25% of public sector bodies carried out a 'role-based' assessment of their 'workers' instead of making a proper assessment for each individual 'worker'. The general picture that seems to be emerging is that, if there is any element of doubt, 'workers' are being 'classified' as employees, with PAYE and NICs being applied accordingly. This, of course, is an expensive option, since the engager authority or agency would typically bear an employer's NIC cost of 13.8% of the gross payment. A further problem is that if a worker does not agree with the engager's decision on their 'status', they have no right of appeal.

As an aside, the 'official view' appears to be that income caught by the 'off-payroll' working regime should be recorded 'gross' in the PSC's accounts. The relevant tax and NIC deducted at source should be charged as an expense in the PSC's profit and loss account (which would be tax deductible for corporation tax purposes). This reflects the 'substance' of the arrangements – the value of the services billed represents the gross amount and the fact that the end-user is paying over the tax on behalf of the PSC. This also aligns with the VAT treatment, since VAT would chargeable on the gross amount

## Extending off-payroll working to the private sector?

The general tenor of HMRC's recent consultation of 'Off-payroll working in the public sector' (18 May 2018) shows that the most likely outcome is an extension of the existing off-payroll working regime to the private sector – which would effectively be the death-knell for IR 35 as we know it! In HMRC's view, non-compliance in the sector is growing and it claims that extending existing 'off-payroll' working rules into the private sector will prevent some £1.2 billion in lost 'tax take' by 2022/23. These are sizeable figures, but HMRC must address

some of the considerable practical difficulties that the existing ‘public-sector’ regime is currently facing.

## Some final thoughts on the *Christa Ackroyd* case

Many BBC and Channel 4 presenters will have been disgruntled with the tribunal’s conclusions in the *Christa Ackroyd* case. This (currently) appears to give the engaging organisations further justification for deducting PAYE/NIC on their payments. But we should remember that *Christa Ackroyd* was not a lead case and the cynic in me thinks that HMRC started with a case that they had the best chance of winning. Attempts by HMRC to use the *Christa Ackroyd* case as a persuasive precedent should therefore be treated with caution. Always look at the relevant facts first!

In my view, it looks like Ms Ackroyd may be another unfortunate victim of the IR 35 lottery! Further IR 35 cases involving TV and radio presenters are very likely to follow and may be decided entirely differently. Watch this space…