The Karate Kid

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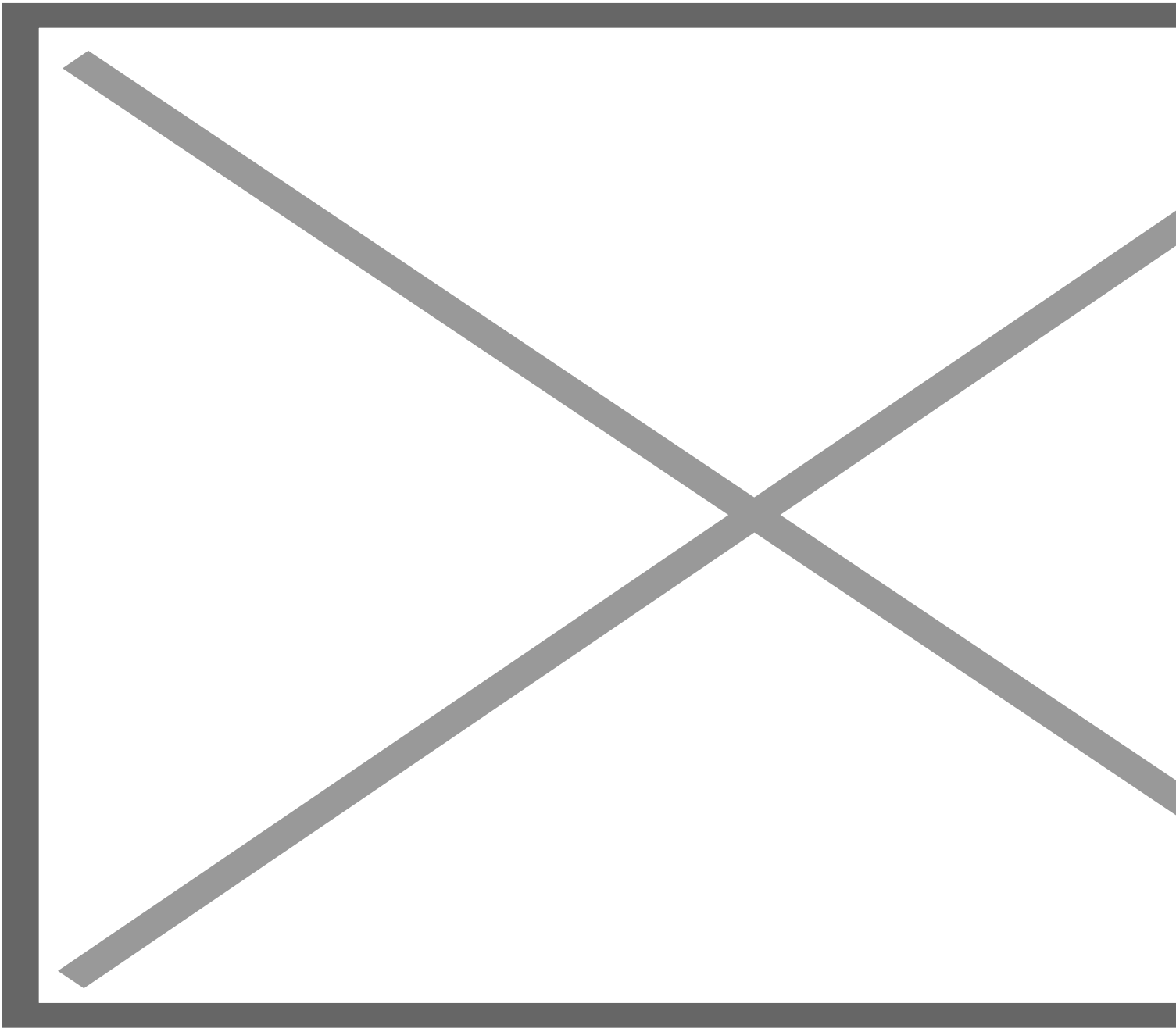

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Keith Gordon discusses *Ashton v HMRC* [2016] UKFTT 727 (TC) which considers a worker's employment status

Key Points

What is the issue?

Employment status is often not a simple, clear cut issue. However, HMRC relied on the paperwork to prove the existence of a partnership, however, the FTT found that despite the paperwork, no partnership actually existed.

What does it mean to me?

This case illustrates that there are a number of practical points that need to be borne in mind, both by taxpayers and HMRC, when dealing with cases regarding employment status.

What can I take away?

The FTT will overrule paperwork when it does not accurately represent the situation. A person's employment status is not a dichotomy.

Facts of the case

The business, Karate World, provides instruction in martial arts. It was originally set up by a Mr Thompson as a sole-trader business, with a number of employees. One of those employees was Remi Ashton, the Appellant in the present case.

In October 2003, the proprietor of Karate World considered options to grow the business and converted the business to a partnership, taking on a number of his employees as partners. Again, this included Mr Ashton. Until 2011, when he left the business, Mr Ashton submitted his Self-Assessment returns as a partner and paid Class 2 contributions on that basis.

An enquiry was opened into Mr Ashton's 2011 tax return because of a mismatch between the figures shown as his partnership income and the equivalent figures on the partnership return itself. Mr Ashton challenged the conclusion of the HMRC enquiry on the basis that he was not in fact a partner of Karate World.

The Tribunal's decision

The Tribunal (Judge Anne Fairpo sitting with Member Ruth Watts Davies) summarised the evidence given by the various parties.

Mr Ashton had been training with Mr Thompson since Mr Ashton was ten years old, going on to compete in the world championships. Mr Ashton stated that he was used to following Mr Thompson's lead.

Mr Ashton said that the business was restructured when he was about 21 or 22 years old. This was at the time that it started to adopt the 'Leigh Childs' system of operating a martial arts business, which concerned both the method of teaching classes and the operation of memberships.

Mr Ashton explained that he had been told that he would 'become self-employed', but no mention was made to him of becoming a partner in the business, at least initially. Mr Thompson had advised Mr Ashton that this was the best way to run the school and Mr Ashton had no reason to doubt this. At the time, there were four people involved in the business: Mr Thompson, Mr Ashton and two others.

Mr Thompson was said to have an iron grip over what was done by the individuals involved in the business, including where and when they worked. This included (when the business expanded to provide more than one school) where Mr Ashton might be required to work at any time. Mr Thompson dictated the times of the classes to be taught by Mr Ashton, the syllabuses to be taught and also when Mr Ashton was required to be on site. The documentation provided to Mr Ashton went so far as to provide a minute-by-minute schedule of how each class should be taught.

The weekly meetings of the 'partners' were in fact staff training sessions conducted by Mr Thompson and were never described as partner meetings.

Mr Ashton received a fixed pay each month together with a bonus payment based on the performance of the school where he worked. He was required to book holiday in advance; when he was away following an appendectomy, he continued to receive full pay. He took no financial risk in the business and had no access to the partnership bank accounts. He accepted that he was a signatory to one of the partnership bank accounts but could not explain why this was as he had nothing to do with the account.

The Tribunal asked Mr Ashton whether he could send a substitute – it was explained that this was difficult because of the level of expertise needed to teach his classes. When Mr Ashton had been ill, his classes were taken by Mr Thompson or other senior staff members.

HMRC's evidence was principally documentary. Mr Ashton's name featured on partnership tax returns prepared by Karate World and Mr Ashton had been registered for (and paid) Class 2 National Insurance contributions. In addition, HMRC gave (hearsay) evidence of a meeting with Mr Thompson where Mr Ashton's importance within the business had been explained. In his own evidence Mr Ashton explained that he had been asked by Mr Thompson to learn and teach new techniques; he had not influenced Mr Thompson to adopt them.

With these findings of fact, the Tribunal then proceeded to consider the key questions in the case.

First, the Tribunal (with reference to the statutory definition of partnership in the Partnership Act 1890) considered that Mr Ashton was not carrying on a business in common with Mr Thompson or others with a view to profit. Consequently, he was not a partner in that business.

Secondly (although not expressly referring to the judgment of Mr Justice MacKenna in *Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance* [1968] 2 QB 497) the Tribunal considered the indicators and key components of an employment relationship. It concluded that there was a mutuality of obligations (one of the 'irreducible' indicia of an employment relationship, but not determinative of the question). In addition, whilst noting that a level of control was to be expected in a business teaching martial arts, 'the degree of control exerted by the business … went beyond that required for consistency and this tends towards a finding of employment status'. Furthermore, other factors were either neutral or pointed towards an employment relationship.

On balance, therefore, the Tribunal concluded that Mr Ashton had discharged the burden of proof and demonstrated to the Tribunal that he was in fact an employee of the business.

Commentary

It is unlikely that this case will go down in history as a major tax case. Nevertheless, it provides examples of a number of important practical issues that taxpayers and HMRC should regularly bear in mind.

First of all, the Tribunal recognised that an individual worker's status was more than a simple dichotomy. As the Tribunal said, first they had to consider whether or not Mr Ashton was a partner in the Karate World business and, then, if not, whether or not he was an employee of that business. It was not the case that the answer to the first question automatically answered the second.

Secondly, the Tribunal was not distracted by the fact that the paperwork indicated that Mr Ashton was a partner in the business. In many ways, it would seem that the thrust of HMRC's case was the fact that the documents said 'X' and, therefore, 'X' must be correct. It will, of course, be realised that there are many cases where HMRC would (correctly) argue that the paperwork is not determinative and that one must instead look at the reality of the situation.

Thirdly, it appears that the Tribunal was not provided with the benefit of direct evidence from Mr Thompson himself. The reasons for this are unclear. Instead, HMRC were content to rely on notes of a meeting with him as evidence of the existence of a partnership. It is quite possible that Mr Thompson's live evidence could have changed the Tribunal's overall perception of the facts. On the other hand, it might have reinforced the view that the Tribunal eventually formed. Nevertheless, it does serve as a reminder that live witness evidence will often be critical in cases such as this, where the Tribunal's perception of the overall facts is key.

Furthermore, it is worth remembering that it is usually taxpayers who argue that they are self-employed and it is HMRC who tend to suggest that there is an employment relationship. This case is one of a small collection of exceptions to the general rule.

The case was also unusual in the sense that it started as one focusing on an HMRC investigation into what they considered to be overstated business expenditure. It is unclear whether HMRC pursued that at the assumed partnership level (with Mr Ashton simply challenging the consequential impact on him) or whether the thrust of HMRC's challenge was focused on Mr Ashton himself. In the end, at least so far as Mr Ashton was concerned, HMRC went away empty handed.