

Dragonfly Consultancy Ltd - IR35 case - egos[®]

The High Court Appeal decision on 3rd September 2008

This case concerned an Agency contract, and a succession of consecutive extensions, covering a period from January 2000 (3 months before the IR35 legislation came into effect) until January 2003, all for the same Client, and during which period the Individual was successively involved in 3 projects.

The Agency-Client contract remained on the same pre-IR35 terms throughout.

The provisions of the Contractor-Agency contract changed slightly from contract to contract.

The decision as to whether or not any particular contract falls within IR35 requires consideration of the nature of the terms of a hypothetical contract between Individual and Client.

These terms are to be found by taking into account all the circumstances, including the terms on which the services are provided, and having regard to the terms of the contracts forming part of the arrangements under which the services are provided. On that basis, it is then necessary to answer the question, would that hypothetical contract be one of employment?

This question is one of mixed law and fact, and from that it follows that a decision of a Special Commissioner will only be open to challenge on the basis that the Special Commissioner has erred on a point of law, or has reached a conclusion which cannot reasonably be justified by the Special Commissioner's findings on the facts.

For this reason, the Special Commissioner's decision remains important, subject to any clarification / correction in the appeal judgment.

Special Commissioner's decision

The Special Commissioner's decision in December 2007 reached the following conclusions as to the nature of the hypothetical contract between Individual and Client:

- 1 There would be a series of contracts, each with a fixed term, and with no obligations on any party to renew.
- 2 Each contract would be terminable prematurely by either party on 28 days written notice without cause.
- 3 Each would also be terminable by written notice if the Individual's performance was unsatisfactory.
- 4 Each would be for the Individual's services; a substitute could be provided, but only if the Client had first notified acceptance of (a) the substitute, and (b) the period for which the substitute would be accepted.
- 5 The Individual would be engaged to undertake tasks allocated to him, within the framework of the project timetable, and subject to the guidance of the team and of its manager.
- 6 Payment would be made at a daily rate for the days actually worked.
- 7 For the first and third projects, most of the work would have been required to be done at the Client's premises; for the second, it would have been required to be done at the Client's premises to the extent necessary to do the work only.
- 8 There would have been no provision for pension, holiday pay, or sick pay.
- 9 There would have been no provision for appraisal.

On the basis of those facts, the Special Commissioner then applied the law.

He first looked at the test set out in *Ready Mixed Concrete* 1968, where it was said:

A contract of service exists if these three conditions are fulfilled.

(i) The servant agrees that, in consideration of a wage or other remuneration, he will provide his own work and skill in the performance of some service for his master.

(ii) He agrees, expressly or impliedly, that in the performance of that service he will be subject to the other's control in a sufficient degree to make that other master.

(iii) The other provisions of the contract are consistent with its being a contract of service.'

He referred to the clarification of this in *Montgomery v Johnson Underwood* 2001, in which it was said:

'It permits Tribunals appropriate latitude in considering the nature and extent of "mutual obligations" in respect of the work in question and the "control" an employer has over the individual. It does not permit those concepts to be dispensed with altogether. As several recent cases have illustrated, it directs Tribunals to consider the whole picture to see whether a contract of employment emerges. It is though important that "mutual obligation" and "control" to a sufficient extent are first identified before looking at the whole.'

In *Market Investigations* 1969, the above was qualified, and the fundamental question was said to be:

"Is the person who has engaged himself to perform these services performing them as a person in business on his own account?". If the answer to that question is "yes", then the contract is a contract for services. If the answer is "no" then the contract is a contract of service. ...control will no doubt always have to be considered, although it can no longer be regarded as the sole determining factor; and that factors, which may be of importance, are such matters as whether the man performing the services provides his own equipment, whether he hires his own helpers, what degree of financial risk takes, what degree of responsibility for investment and management he has, and whether and how far he has an opportunity of profiting from sound management in the performance of his task'.

This, he suggested, was comparable with the 'consistency' condition in *Ready Mixed Concrete*. (This section was referred to in the Special Commissioner's judgment, though not expressly quoted; it was however quoted in the appeal judgment.)

He also referred to *Hall v Lorrimer* 1993, in which it was said that:

"In order to decide whether a person carries on business on his own account it is necessary to consider many different aspects of that person's work activity. This is not a mechanical exercise of running through items on a check list to see whether they are present in, or absent from, a given situation. The object of the exercise is to paint a picture from the accumulation of detail. The overall effect can only be appreciated by standing back from the detailed picture which has been painted, by viewing it from a distance and by making an informed, considered, qualitative appreciation of the whole. It is a matter of evaluation of the overall effect of the detail, which is not necessarily the same as the sum total of the individual details. Not all details are of equal weight or importance in any given situation. The details may also vary in importance from one situation to another.

He went on to say that the following indicia may be relevant:

- (a) does the taxpayer provide his own equipment?
- (b) does the taxpayer hire his own helpers?

(c) what degree of financial risk does the taxpayer bare and what opportunity for profit does the taxpayer have?

(d) what degree of responsibility for investment and management does the taxpayer have?

(e) is the taxpayer part and parcel of his "employer's" organisation (see Hall v Lorimer);

(f) the degree of control to which the taxpayer is subject (rather than the mere existence of a right of 'control');

(g) termination provisions – termination on notice may be a pointer towards employment in some cases (it was found to be so in Morren v Swinton (1965) 1 WLR 576 but found to be neutral in McManus v Griffiths 1997 70 TC 218);

(h) the intention of the parties.

He then discussed mutuality in some detail, reaching the conclusion that for the required degree of mutuality of obligation to be present, the key obligation on the individual's part was in his view for the individual to provide services personally; and on the 'employer's' part simply to pay for such work as was in fact done – it was not necessary for there to be an obligation to either provide work, or to pay in lieu.

He also discussed control and substitution in some detail (not repeated here, because these were the subject of the appeal).

He applied the various tests to the hypothetical contract as follows:

1 The Individual was to provide his own work and skill, for which the Client would be require to pay – and this was not undermined by the limited possibility/right of substitution.

2 The submission to guidance of the team and the team manager was enough to give rise to a sufficient right of control.

3 As to the other provisions of the contract, he took the following views:

a. Very limited right of substitution not inconsistent with employment, did not point strongly away from it

b. Degree of control as expected from a skilled professional employee, and pointed towards employment

c. Intention of the parties as regards whether or not there was to be employment seemed irrelevant

d. Nature of work required use of Client's computer and premises, therefore not pointing towards employment; some 'own equipment' provided, pointing marginally away from employment

e. Individual bore costs of training and phone lines – pointed weakly away from employment

f. Work only undertaken for one other client, not a significant part of income; a weak pointer away from employment

g. Ability to increase profit limited; risks of payment against invoice, but little economic risk; risk associated with no sick pay; negotiated higher and lower rates with state fo market; weak pointers away from employment.

Against the background of the above, he took the view that there was nothing pointing strongly to the conclusion that the Individual would have been in business on his own account, and saw a picture of an individual with a role similar to that of a professional employee. The individual was not engaged to provide a specific product, but was there to be used by the Client in performing tasks allocated from time to time. Whilst engaged in relation to a project, he was not required to deliver anything other than his services in relation to the project.

The Special Commissioner concluded that the individual would have been an employee, under the provisions of the hypothetical contract – and therefore that the engagements fell within the scope of IR35.

Appeal

The Special Commissioner's decision was challenged on appeal in the following four areas:

1 Substitution.

By way of background, for the nature of a relationship (actual, or hypothetical) to be employment, it is a pre-condition that the individual must be required to provide *his own* services.

The significance of a right of substitution is that such a right, where genuine and unfettered/unqualified, is capable of establishing that the individual is not *personally* required to provide services – and therefore that as a result of that simple right, the relationship (actual, or hypothetical) cannot be one of employment.

Here, the facts were that the first Contractor-Agency contract gave an apparent right to substitute, but only with the Agency's prior written consent. Later contracts/extensions had differing provisions; some did not mention the Individual by name, although that was not considered material, the view being taken that the Contractor was a one man company, whose sole raison d'etre was to supply the Individual's services.

In any event, the Agency-Client contract contained no rights of substitution; no substitute was ever in fact provided; the Client operated a CV-based selection procedure, and expected the Individual to provide the services personally.

The absence of any unfettered rights to substitute in the Agency-Client contract, and of any evidence of variation by a course of conduct, resulted in there being no sufficient right of substitution to displace the conclusion that there was an obligation on the Individual to provide the services personally.

2 Control.

In Ready Mixed Concrete 1968, referred to above, the 'control' requirement was amplified as follows:

Control includes the power of deciding the thing to be done, the way in which it shall be done, the means to be employed in doing it, the time when, and the place where it shall be done. All these aspects of control must be considered in deciding whether the right exists in a sufficient degree to make one party the master and the other his servant. The right need not be unrestricted.... To find where the right resides one must look first to the express terms of the contract, and if they deal fully with the matter one may look no further. If the contract does not expressly provide which party shall have the right, the question must be answered in the ordinary way by implication.

Here, early contracts expressly provided that the Contractor company was engaged to provide the individual to perform services under the Client's

- 'direct supervision and control' (first contract)
- 'direction' (second contract)

The simple omission of these words from the later extensions was considered to be probably no more than an attempt at IR35 avoidance.

Early contracts also contained provisions requiring the individual to comply with 'customary rules and regulations for the conduct of the Client's own staff and the Client's

customary working procedures and security measures’.

Later contracts replaced this term – but again, in the absence of any evidence as to a real change in the position on the ground, or that the later wording more effectively/accurately reflected the real world position, the replacement was considered to be no more than an attempt at IR35 avoidance.

The Agency-Client contract contained provision that the staff supplied by the agency would be ‘under the full control of (the Client) on a day to day basis only regarding performance of their duties’.

It was noted that the Special Commissioner had found as facts that the Individual’s progress had been monitored by the team manager; and that there had been ongoing informal appraisal of his work – despite the lack of any provision for appraisal in the hypothetical contract.

Overall, whilst the Special Commissioner said that control could not be spelt out of the words of the formal contracts, he concluded that the Individual

- worked as part of the team
- undertook work that was allocated to him
- was informally monitored
- was subject to guidance of the team and its manager

and that the hypothetical contract would have contained provision that the Individual would undertake the tasks allocated to him, with a specific but reviewable timeframe, and would accept the Client’s reasonable directions in relation to what he was doing.

The Appeal judge’s view was that the Special Commissioner’s finding that the Individual’s performance of his duties was subject to a degree of supervision and quality control which went beyond merely directing him when and where to work; and he commented that in the case of a self-employed worker, you would not normally expect to find regular appraisal and monitoring of the kind found here. Thus the Special Commissioner could not as a matter of law be faulted in his conclusion that the Client’s right of control under the hypothetical contract was sufficient to justify, and on balance a pointer towards, employment.

3 Intention.

Background: In a borderline case, the intentions of the parties as to whether there is employment or not can help tip the balance.

Here, it was argued that no party intended employment.

The Special Commissioner had concluded that the intentions of the parties were irrelevant.

The Appeal Judge took the view that statements by the parties disavowing any intention to create a relationship of employment cannot prevail over the true legal effect of the agreement (or hypothetical agreement) between them. This case was not close enough to the borderline for the intentions to make any difference to the result.

4 Worker.

Background: for some purposes (eg Working Time Regulations), the law recognises not only the categorisations of ‘employed’ and ‘self-employed’, but also ‘worker’.

It was argued that such a category should be considered as a third possibility in relation to IR35.

This was rejected, on the basis that the category of 'worker' only has relevance in relation to particular statutory contexts; in relation to IR35, the statutory question is simply whether or not the hypothetical contract would be a contract of service (ie employment), or not.

The appeal was therefore dismissed; the Contractor was found to have been within IR35.

Comment

A combination of factors brought this case down.

The simple fact that the case concerned a succession of contracts and extensions, commencing before the introduction of IR35, all for the same client, the terms of which contracts changed in details from contract to contract, left a fair degree of uncertainty as to what the terms actually were; and the succession of changes, intended to create a more IR35-friendly background, probably lead to the conclusion that they were solely there for that purpose, and thus undermined their own credibility – the damage had already been done.

The succession of extensions compounded the risks – just as there are ways in which a later and better worded extension can potentially improve the position for earlier periods, provided it accords with reality, the converse can potentially apply – ie earlier less favourable terms can drag down later and more favourable terms. It's a question of whether or not one can show that the later term in fact more accurately represents the reality.

It has long been recognised that overstaying one's welcome with a particular Client can compound IR35 risks, particularly where (as here) an appearance is created of the individual gradually becoming integrated into a team.

The fact that the Agency-Client contract had been entered before IR35 was even a twinkle in the eye of Gordon Brown clearly did not help!

On control, the case makes clear that where

- an engagement is to do work allocated as the contract progresses (as opposed to agreed at the outset), that may be capable of amounting to a sufficient degree of 'control-what'
 - there is a submission to guidance, or monitoring, or appraisal, that may be capable of amounting to a sufficient degree of 'control-how'
- to put the hypothetical relationship between Individual and Client at risk of being considered to be one of 'employment', for IR35 purposes.

Clearly, contractual provisions in early contracts which expressly provided that the Contractor company was engaged to provide the individual to perform services under the Client's

- 'direct supervision and control' (first contract)
- 'direction' (second contract)

and requiring the individual to comply with 'customary rules and regulations for the conduct of the Client's own staff and the Client's customary working procedures and security measures' were unhelpful, even as background and not specifically relied on in the conclusions - it's hard to interpret them in any other way than that the individual was expected to 'fit in' and become part and parcel of the Client's organisation as if he were an employee.

The true meaning of Mutuality of Obligation – 'MOO' – may be taken to have been further clarified; whilst it remains a negative from an IR35 viewpoint to be entitled to payment other than for services actually provided, to avoid that is not a complete get-out; at its

barest essential, an obligation to provide services **personally** (ie without a genuine and unfettered right to substitute), in return for payment, will generally be regarded as sufficient MOO to constitute the basis for an employment-type relationship, if other factors too support that conclusion. So it must now be accepted that MOO can exist, without any obligation on the part of the engager to either provide work, or to pay in lieu; though of course if there were such obligations, they would clearly be additional negative factors.

On substitution: the Contractor was a 'one man' company, and it was said that its sole *raison d'être* was to supply the Individual's services; the suggestion was made that the fact that such a company entered a contract which did not mention the Individual by name might not of itself be sufficient to undermine the implication of an obligation to provide services personally. Admittedly here it was in the context of a sequence of contracts, of which some earlier and some later did name the Individual. Nevertheless, this gives some cause for concern.

Two or more contractors might consider using a 'partnership company', to help avoid the suggestion that the sole *raison d'être* is to supply the services of but one individual. They would need to manage this themselves, of course, to steer clear of the MSC legislation, But for such a company to contract for specified services, without any individual being named, would clearly help avoid the suggestions here that the only implication was that the one person behind the company would be doing all the work.

Overall

Whichever way one views it, this is a case which sets out the detailed interpretation of IR35, in a way which is clear and logical, and will provide a valuable first point of reference for the future. You may not like it, but at least this spells out what you have to do to work around it!

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